

BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF HAWAII

In the Matter of the Application of)

MAUI ELECTRIC COMPANY, LIMITED )

DOCKET NO. 2017-0150

For Approval of General Rate Case )  
and Revised Rate Schedules/Rules. )  

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DECISION AND ORDER NO. 36219

PUBLIC UTILITIES  
COMMISSION

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## TABLE OF CONTENTS

I.	BACKGROUND .....	6
A.	Related Commission Dockets .....	7
1.	Docket No. 2014-0318 .....	7
2.	Docket No. 2016-0431 .....	10
B.	MECO's Application .....	12
C.	Public Hearings .....	16
D.	Relevant Procedural History .....	17
E.	Statement Of Issues .....	21
II.	DISCUSSION .....	23
A.	The Parties' Settlement Agreement .....	23
B.	Resolution Of Deferred Issues .....	24
1.	MECO's ROE .....	24
2.	Blue Planet's Proposed ECAC Modifications .....	27
i.	Parties And Positions .....	27
ii.	Policy Considerations Regarding Blue Planet's Proposal .....	34
iii.	Determining The Magnitude Of Partial ECAC Adjustment .....	40
iv.	Review And Approval Of The ECRC Tariff .....	46
3.	Cost Recovery Issues Related To Docket No. 2016-0219 .....	51
4.	Cost Recovery Issues Related To Docket No. 2016-0345 .....	64
5.	Schedule J And P Demand Ratchet Options And DSM Tariffs .....	68
i.	Schedule J And P Demand Ratchets .....	68
ii.	DSM Tariff .....	69
C.	Test Year Determinations .....	72
1.	Operating Revenues .....	74
i.	Electric Sales Revenue .....	74
ii.	Other Operating Revenue (Including Gain On Sale Of Land) .....	77

iii.	Summary .....	83
2.	Operations And Maintenance Expenses .....	83
i.	Non-Specific O&M Account Adjustments .....	84
ii.	Fuel .....	88
iii.	Purchased Power .....	90
iv.	Production .....	91
v.	Transmission And Distribution .....	94
vi.	Customer Accounts .....	96
vii.	Customer Service .....	101
viii.	Administrative And General .....	107
ix.	Customer Benefit Adjustment .....	112
x.	Total O&M Expenses .....	114
3.	Non-O&M Expenses .....	114
i.	Depreciation & Amortization .....	115
ii.	Amortization Of The State Investment Tax Credit .....	117
iii.	Taxes Other Than Income Tax .....	121
iv.	Interest On Customer Deposits .....	122
v.	Income Taxes .....	125
vi.	Total Non-O&M Expenses .....	131
4.	Average Rate Base - Investment In Assets .....	131
i.	Net Plant-In-Service .....	135
ii.	Property Held For Future Use .....	139
iii.	Fuel Inventory .....	140
iv.	Materials & Supplies Inventories .....	141
v.	Unamortized Net ASC 740 Regulatory Asset/Liability .....	142
vi.	Pension Tracking Regulatory Asset .....	145
vii.	Deferred System Development Costs & Other Deferred Costs .....	149
viii.	Contributions In Excess Of NPPC .....	152
5.	Average Rate Base - Funds	
	From Non-Investors .....	155
i.	Unamortized Contributions In Aid Of Construction .....	156

ii.	Customer Advances .....	158
iii.	Customer Deposits .....	159
iv.	Accumulated Deferred Income Taxes .....	160
v.	Unamortized State Investment Tax Credit .....	161
vi.	Unamortized Gain On Sale (Of Land) .....	163
vii.	OPEB Regulatory Liability .....	164
6.	Average Rate Base - Working Cash .....	167
7.	Test Year Average Rate Base .....	171
8.	Rate Of Return .....	171
9.	Revenue Allocation And Rate Design .....	173
i.	MECO .....	174
ii.	The Consumer Advocate .....	182
iii.	The Parties' Stipulation Regarding Rate Design .....	187
iv.	Approving The Parties' Stipulated Rate Design .....	190
10.	Implementation Of Final Rates .....	191
D.	HRS § 269-16(d) Statutory Refund Provision .....	192
E.	Hawaii's Energy Policy Statutes .....	194
III.	SUMMARY OF FINDINGS OF FACT AND CONCLUSIONS OF LAW .....	203
IV.	ORDERS .....	207

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and Revised Rate Schedules/Rules. )

Decision and Order No. **36219**

DECISION AND ORDER

By this Decision and Order,<sup>1</sup> the Public Utilities Commission ("commission") approves a change in rates for MAUI ELECTRIC COMPANY, LIMITED, as described herein. The commission determines that the appropriate return on common equity ("ROE") for the 2018 calendar test year ("2018 Test Year") is 9.50%, which reflects the commission's partial approval of the Parties' stipulated settlement agreement filed on June 15, 2018

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<sup>1</sup>The Parties to this docket are MAUI ELECTRIC COMPANY, LIMITED ("MECO" or the "Company"), and the DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS, DIVISION OF CONSUMER ADVOCACY ("Consumer Advocate"). In addition, the commission has granted Participant status to BLUE PLANET FOUNDATION ("Blue Planet"). See Order No. 35333, "(1) Partially Granting Blue Planet's Motion to Intervene By Granting Alternative Request for Participant Status in Lieu of Intervention; (2) Granting, in Part, the Division of Consumer Advocacy's Motion for Enlargement of Time; and (3) Modifying the Procedural Schedule," filed March 7, 2018 ("Order No. 35333").

("Settlement Agreement").<sup>2</sup> Based on the stipulated 9.50% ROE, the commission approves as fair a rate of return on average rate base of 7.43%, which shall apply to the calculation of final rates for the 2018 Test Year.

As for the remaining 2018 Test Year determinations on, for example, revenue forecasts, operating expenses, and average rate base, the commission partially approves the Parties' agreed-upon terms as reflected in the Settlement Agreement, subject to the following modifications, which are discussed in greater detail below. In particular, the commission excludes from MECO's 2018 Test Year the costs associated with the Ka'ono'ulu substation project ("Ka'ono'ulu Project") and a portion of the costs associated with the Kuihelani substation project ("Kuihelani Project") (collectively, the "Substation Projects"); however, as discussed below, the commission will allow MECO to receive interim recovery for these excluded amounts through the Rate Adjustment Mechanism ("RAM"), outside of the operation of the RAM Cap. In addition, pursuant to Decision and Order No. 36159,<sup>3</sup> MECO may include its amortized deferred O&M expenses for the

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<sup>2</sup>See Maui Electric Company, Limited; 2018 Test Year; Parties' Stipulated Settlement Letter; Docket No. 2017-0150, filed on June 15, 2018.

<sup>3</sup>See In re Maui Elec. Co. Ltd., Docket No. 2016-0345, Decision and Order No. 36159, filed February 11, 2019 ("D&O 36159").

Ma`alaea Low-Load Modification Project ("Ma`alaea Project") in its 2018 Test Year.

MECO shall collaborate with the Consumer Advocate to prepare and submit revised schedules of operations reflecting the aforementioned rulings within thirty (30) days of this Decision and Order for the commission's review and approval. The commission also notes that the revenues from MECO's sale of real property in Paia, Maui, which was the subject of Docket No. 2017-0423 (the "Paia Land Sale"), are no longer considered confidential and should be reflected in their appropriate categories in the Parties' revised schedule of operations submission.

In addition, the Parties shall also collaborate to submit proposed revised tariff sheets reflecting the rulings set forth below, and reflected in the revised schedules of operations, for the commission's review and approval within thirty (30) days of this Decision and Order.

Furthermore, as the aforementioned costs associated with the Substation Projects were included in the Settlement Agreement and incorporated in MECO's interim rates, those costs that are now excluded from final rates, but have been collected from customers through interim rates, must be refunded pursuant to HRS § 269-16(d). There is also some ambiguity regarding whether MECO's Fast Demand Response ("DR") program expenses, which were included in MECO's interim rates, have also been collected through

MECO's Demand-Side Management ("DSM") Surcharge. To the extent such costs were recovered through both mechanisms, a refund is required. MECO shall collaborate with the Consumer Advocate to propose a method of refunding these amounts, consistent with HRS § 269-16(d), to the commission within thirty (30) days of this Decision and Order.

With regard to the remaining disputed issue between the Parties and Participant Blue Planet, the commission determines that the Energy Cost Adjustment Clause ("ECAC") mechanism shall be replaced with a new mechanism that reflects a risk-sharing approach similar to that proposed by Blue Planet in this proceeding. However, the mechanism approved by the commission shall reflect a 98%/2% risk-sharing split between customers and the Company, with an annual maximum exposure cap of ±\$633,000, rather than the 95%/5% split, ±\$4.2 million maximum exposure cap proposed by Blue Planet.<sup>4</sup>

As stated and agreed to by the Parties in the Settlement Agreement, MECO has proposed a new Energy Cost Recovery Clause ("ECRC") provision tariff, to become effective three months after final rates in this proceeding go into effect.<sup>5</sup> The new ECRC

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<sup>4</sup>See "Blue Planet Foundation's Testimony and Exhibit List; Direct Testimony of Ronald J. Binz; Exhibits '1' to '3'; and Certificate of Service," filed April 16, 2018 ("BP Direct Testimony"), at 29.

<sup>5</sup>See Settlement Agreement, Exhibit 1 at 11-14.



tariff will provide for the recovery of fuel and purchased energy costs and effectuate the removal of the recovery of fuel and purchased energy costs from base rates, as instructed by the commission,<sup>6</sup> and will replace and incorporate the operative functions of the ECAC tariff, including the risk-sharing mechanism approved in this Decision and Order. In addition, the Parties have stipulated to revisions to the existing ECAC, including provisions for the process for interim re-determination of the ECAC target heat rates.

The commission therefore instructs MECO to submit an initial draft of its proposed ECRC tariff, consistent with the findings discussed herein, within thirty (30) days of this Final Decision and Order. The Consumer Advocate and Blue Planet may file comments to MECO's revised ECRC proposal within fifteen (15) days of MECO's submission. MECO may file reply comments within seven (7) days of the Consumer Advocate and Blue Planet's comments. Commission approval and further direction to implement the ECRC shall be provided in a subsequent commission order.

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<sup>6</sup>See In re Public. Util. Comm'n, Docket No. 2013-0141, Order No. 34514, "Establishing Performance Incentive Measures and Addressing Outstanding Schedule B Issues," filed April 27, 2017 ("Order No. 34514").

In sum, pursuant to this Decision and Order:

(A) Within thirty (30) days of this Decision and Order, the Parties shall submit proposed tariffs reflecting MECO's final rates, with supporting revised schedules of operations, consistent with the commission's rulings herein (this does not include MECO's proposed ECRC tariff, which will be approved according to a separate review process).

(B) Within thirty (30) days of this Decision and Order, the Parties shall submit a proposed method for refunding to its customers any excess amounts collected through interim rates, pursuant to HRS § 269-16(d);

(C) Within thirty (30) days of this Decision and Order, MECO shall submit a revised proposed ECRC tariff. The Consumer Advocate and Blue Planet may file comments to MECO's revised ECRC proposal within fifteen (15) days of MECO's submission. MECO may file reply comments within seven (7) days of the Consumer Advocate and Blue Planet's comments

## I.

### BACKGROUND

MECO is a Hawaii corporation and an operating public utility engaged in the production, purchase, transmission, distribution, and sale of electricity on the island of Maui; the production, transmission, distribution, and sale of

electricity on the island of Molokai; and the production, purchase, distribution, and sale of electricity on the island of Lanai.<sup>7</sup>

A.

Related Commission Dockets

1.

Docket No. 2014-0318

On August 31, 2010, the commission, in its decoupling investigative proceeding, In re Public Util. Comm'n, Docket No. 2008-0274 ("Docket No. 2008-0274"), issued its Final Decision and Order, by which the commission adopted a Mandatory Triennial Rate Case Cycle for the Companies.<sup>8</sup> Pursuant thereto, the HECO Companies<sup>9</sup> were directed to file staggered rate cases every three years, commencing with HECO's 2011 test year rate case, followed by either MECO's or HELCO's 2012 test year rate case, then MECO's or HELCO's 2013 test year rate case.

On October 17, 2014, MECO filed its Notice of Intent to file, by December 31, 2014, a general rate case application based

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<sup>7</sup>Mauui Electric Company, Limited 2018 Test Year; Application, filed October 12, 2017 ("Application"), at 20.

<sup>8</sup>Docket No. 2008-0274, Final Decision and Order, filed on August 31, 2010 (Commissioner Kondo, Leslie H., dissenting), at 129.

<sup>9</sup>The "HECO Companies" refers collectively to MECO, Hawaiian Electric Company, Inc. ("HECO") and Hawaii Electric Light Company, Inc. ("HELCO").

on a 2015 calendar test year period, in accordance with the commission's Mandatory Triennial Rate Case Cycle.<sup>10</sup>

On December 30, 2014, MECO submitted its "filing" based on the 2015 test year, which it characterized as its "abbreviated rate case filing."<sup>11</sup> MECO alleged that its abbreviated rate case filing would support an increase in 2015 test year revenues of \$11,550,000, or an increase of 2.8% over revenues at current effective rates.<sup>12</sup> Nonetheless, MECO stated that it intended to forgo the opportunity to seek a general increase in its base rates.<sup>13</sup> MECO stated that it submitted its abbreviated rate case filing to "expeditiously obtain a [commission] decision that there will be no change in base rates at this time."<sup>14</sup> MECO's "next rate

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<sup>10</sup>Docket No. 2014-0318, "Maui Electric Company, Limited Notice of Intent; Verification; and Certificate of Service," filed October 17, 2014.

<sup>11</sup>Docket No. 2014-0318, "Maui Electric Company, Limited 2015 Test Year Rate Case Filed December 30, 2014, Book 1," filed December 30, 2014 ("MECO abbreviated rate case filing" or "MECO 2015 Filing"), at 2 ("To that end, the Company is offering this abbreviated rate case filing to expeditiously obtain a decision that there will be no change in base rates at this time. . . . Maui Electric intends this abbreviated filing to satisfy its obligation to file a rate case under the three-year general rate case cycle established by the Commission in its Decoupling Final D&O.").

<sup>12</sup>MECO 2015 Filing at 2.

<sup>13</sup>MECO 2015 Filing at 1 ("By this filing, the Company intends to forego [sic] the opportunity to seek a general rate increase in base rates.").

<sup>14</sup>MECO 2015 Filing at 2.

case according to the normal rate case cycle would use a 2018 test year," although MECO also stated that "[i]f circumstances change significantly, it may be necessary to file the next rate case earlier."<sup>15</sup>

As a result of the MECO 2015 Filing, the commission issued Order No. 34739 on August 4, 2017, which transferred and consolidated Docket No. 2014-0318 with the present proceeding, Docket No. 2017-0150.<sup>16</sup> In Order No. 34739, the commission found that MECO's 2015 Filing was non-compliant with the Mandatory Triennial Rate Case Cycle, but declined to initiate an investigative or enforcement proceeding against MECO.<sup>17</sup> Rather, the commission transferred and consolidated Docket No. 2014-0318 into Docket No. 2017-0150 "to ensure that ratepayers receive the attendant benefits of MECO's abbreviated rate case filing."<sup>18</sup> As a result, "the determination and disposition of any rates, accounts, adjustment mechanisms, and practices that would have been subject to review in the context of a 2015 test year rate case proceeding [for MECO] are subject to appropriate adjustment based on evidence

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<sup>15</sup>MECO 2015 Filing at 11.

<sup>16</sup>See Order No. 34739, "Transferring and Consolidating Docket No. 2014-0318 with Docket No. 2017-0150, and Closing Docket No. 2014-0318," filed August 4, 2017 ("Order No. 34739").

<sup>17</sup>See Order No. 34739 at 13-15.

<sup>18</sup>Order No. 34739 at 15.

and findings in the consolidated rate case proceeding, Docket No. 2017-0150."<sup>19</sup>

A similar transfer and consolidation was executed for HECO's 2017 calendar test year general rate case proceeding (Docket No. 2016-0328), in which HECO's "abbreviated" 2014 test year filing was transferred and consolidated with Docket No. 2016-0328.<sup>20</sup> As a result, the commission encouraged MECO to look to Docket No. 2016-0328 "for guidance on how the commission intends to proceed with this consolidated proceeding and the nature of materials desired by the commission."<sup>21</sup> Likewise, the commission takes administrative notice of Docket No. 2016-0328, including the commission's findings and conclusions therein.<sup>22</sup>

2.

Docket No. 2016-0431

On July 30, 2018, the commission, in In re Hawaiian Elec. Cos., Docket No. 2016-0431 ("Docket No. 2016-0431"), approved

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<sup>19</sup>Order No. 34739 at 16.

<sup>20</sup>See In re Hawaiian Elec. Co., Inc., Docket No. 2016-0328 ("Docket No. 2016-0328").

<sup>21</sup>Order No. 34739 at 20-21.

<sup>22</sup>The commission issued Final Decision and Order No. 35545 in Docket No. 2016-0328 on June 22, 2018 ("D&O 35545").

revised depreciation and amortization rates, as well as a revised Contributions In Aid of Construction ("CIAC") amortization period for all of the HECO Companies.<sup>23</sup>

In Docket No. 2016-0431, the docket parties, the HECO Companies and the Consumer Advocate, reached a settlement agreement which resolved all issues in that proceeding (the "Depreciation Settlement").<sup>24</sup> In the instant proceeding, the Parties reference the Depreciation Settlement in their Settlement Agreement and Joint Statement of Probable Entitlement, acknowledging the Depreciation Settlement's (then) pending status, and providing alternative schedules of operations reflecting the stipulated revenue increase under both the existing depreciation and amortization rates and the revised rates provided for in the Depreciation Settlement.<sup>25</sup>

In light of the issuance of D&O 35606, the commission finds that the alternative estimates and calculations utilizing

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<sup>23</sup>See Docket No. 2016-0431, Decision and Order No. 35606, filed July 30, 2018 ("D&O 35606").

<sup>24</sup>See Docket No. 2016-0431; Letter From: J. Viola To: Commission Re: Docket No. 2016-0431 - Hawaiian Electric Companies and Parties' Depreciation Rates; Stipulated Settlement Agreement, filed March 23, 2018.

<sup>25</sup>See Joint Statement of Probable Entitlement at 2 and Attachments, providing for alternative calculations based on "Existing Depreciation Rates" and "Settlement Depreciation Rates."

the "Settlement Deprecation Rates" should be used.<sup>26</sup> Accordingly, when referencing the Settlement Agreement and Joint Statement of Probable Entitlement, the commission will utilize the figures that incorporate the Depreciation Settlement, to the extent applicable.

B.

MECO's Application

On October 12, 2017, MECO filed its Application seeking the commission's approval of an increase in its revenues of \$30,062,000 (approximately 9.26%) over revenues at current effective rates of \$324,798,000.<sup>27</sup> MECO's requested increase was based on an estimated total revenue requirement of \$354,860,000, reflecting a 8.05% rate of return on an average 2018 Test Year rate base of \$473,270,000, using then-existing depreciation rates.<sup>28</sup> When adjusted to account for the Depreciation Settlement, MECO's Application requested an increase of \$46,558,000

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<sup>26</sup>In Docket No. 2016-0431, the Parties expressly requested that the commission implement the Depreciation Settlement rates in the subsequent general rate case for each of the HECO Companies. In D&O 35606, the commission ruled that the Depreciation Settlement rates would be implemented for MECO in its pending 2018 Test Year rate case (i.e., this proceeding). D&O 35606 at 35-36 and 39.

<sup>27</sup>Application at 7; and "Maui Electric Company, Limited 2018 Test Year; Direct Testimonies and Exhibits," filed October 12, 2017 ("MECO Direct Testimony"), MECO-2501 at 1.

<sup>28</sup>MECO Direct Testimony, MECO-2501 at 1.



(approximately 14.3%) over revenues at current effective rates.<sup>29</sup> This alternative requested increase was based on an estimated total revenue requirement of \$371,356,000, reflecting an 8.05% rate of return on an average 2018 Test Year rate base of \$467,424,000, using the Depreciation Settlement rates.<sup>30</sup>

MECO states that it is filing its Application in accordance with the Mandatory Triennial Rate Case Cycle.<sup>31</sup> MECO asserts that rate relief is required in order to provide it with a reasonable opportunity to recover its prudently incurred costs of providing electric services to customers.<sup>32</sup> MECO points to the recent progress it has made toward contributing to clean energy projects, including increases in renewable wind energy and decreases in fuel oil use, but maintains that it must also make capital investments up front in order to continue its transformation to a renewable energy future.<sup>33</sup>

In addition to an increase in revenues, MECO also requested that the commission approve the following:

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<sup>29</sup>Application at 9; and MECO Direct Testimony, MECO-2509 at 1.

<sup>30</sup>MECO Direct Testimony, MECO-2509 at 1.

<sup>31</sup>Application at 5.

<sup>32</sup>Application at 6.

<sup>33</sup>Application at 3-5.

(A) Modifications to MECO's RAM. MECO proposed the same alternative modifications to the RAM that HECO proposed in Docket No. 2016-0328: (1) determining the baseline plant additions in the RAM period based on the amount of baseline plant additions approved in the most recent rate case, inflated annually by the Gross Domestic Product Price Index; or (2) determining the baseline plant additions in the RAM period based on an average of the projected baseline plant additions in the last rate case test year and the two subsequent years before the next scheduled rate case test year.<sup>34</sup>

(B) Modifications to MECO's Revenue Balancing Account ("RBA") Provision Tariff. MECO proposed to modify the RBA Provision Tariff such that the allocation factor applicable to target revenue is 1/12 per month, with such revision being approved in the Interim Decision and Order and being implemented at the beginning of the calendar year subsequent to commission approval of this modification.<sup>35</sup>

(C) Modifications to MECO's ECAC. MECO proposed to modify its ECAC tariff to: (1) reflect the revised cost of fuel, Distributed Generation fuel, and purchased energy; (2) revise the target heat rates for medium sulfur fuel oil and for diesel fuel

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<sup>34</sup>Application at 16.

<sup>35</sup>Application at 16-17.

for all three MECO divisions to reflect the 2018 Test Year operations; and (3) add a trigger for target heat rate redetermination for all three MECO divisions.<sup>36</sup>

In addition, MECO proposed separating and removing all test year fuel and purchased energy expenses from base rates, with recovery of these costs to occur through an appropriately modified energy cost adjustment mechanism, and to implement such change subsequent to the establishment and implementation of final rates in this proceeding.<sup>37</sup>

(D) Discontinuing MECO's Monthly Curtailment Report.

MECO requested that the commission allow MECO to discontinue filing the monthly curtailment reports that were previously established by Decision and Order No. 31288 ("D&O 31288") in MECO's 2012 test year rate case, Docket No. 2011-0092.<sup>38</sup> MECO contends that it has complied with pertinent provisions of D&O 31288 and should be relieved of this reporting requirement; however, MECO states that it will continue to post certain curtailment metrics on its website, updated on a quarterly basis, in accordance with Order No. 32701, issued on March 11, 2015, in Docket No. 2013-0141.<sup>39</sup>

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<sup>36</sup>Application at 17.

<sup>37</sup>Application at 17-18.

<sup>38</sup>Application at 18. See also, D&O 31288 , filed May 31, 2013, in Docket No. 2011-0092.

<sup>39</sup>Application at 18.

(E) Modifications to Tariff Rule Nos. 3, 7, and 8.

MECO proposed modifications to its existing Rule No. 3 (Application for Service and Changes in Equipment and Operations), Rule No. 7 (Discontinuance and Restoration of Service), and Rule No. 8 (Rendering and Payment of Bills). Specifically, "MECO proposes to: 1) delete a redundant provision for after-hours service connection fees in Rule No. 3; 2) clarify the terms within [the] Service Establishment provision in Tariff Rule No. 7, while standardizing pricing with the other HECO Companies; and, 3) more broadly define Returned Payments in Rule No. 8."<sup>40</sup>

C.

Public Hearings

The commission held public hearings on MECO's Application on January 30, 2018 (Wailuku, Maui), January 31, 2018 (Lanai City, Lanai), and February 6, 2018 (Kaunakakai, Molokai), pursuant to HRS §§ 269-16 and 269-12. Representatives from MECO and the Consumer Advocate testified at each public hearing. Members from the public also testified at the Maui and Lanai public hearings, and a representative from the County of Maui testified

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<sup>40</sup>"Division of Consumer Advocacy's Direct Testimonies, Exhibits, and Workpapers; Books 1 and 2; Docket No. 2017-0150," filed April 16, 2018 ("CA Direct Testimony"), CA-T-2 at 133 (citing MECO-115 at 11-16 and MECO T-11 at 59-62).

at the Molokai public hearing. In general, the members of the public who testified expressed concerns with, or opposition to, the increases in rates proposed by MECO.

D.

#### Relevant Procedural History

On June 9, 2017, MECO filed a notice of intent that it would submit a general rate case application on or after August 17, 2017, but before December 30, 2017, based on a 2018 calendar test year.<sup>41</sup>

On August 4, 2017, the commission issued Order No. 34739, transferring and consolidating Docket No. 2014-0318 with this proceeding.

On October 12, 2017, MECO filed its Application. On November 20, 2017, the commission issued Order No. 35030, in which it certified MECO's Application complete, pursuant to HRS § 269-16(d), as of October 12, 2017.<sup>42</sup>

On December 26, 2017, the commission issued Procedural Order No. 35152, which, among other things, established the Statement of Issues and procedural schedule governing this

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<sup>41</sup>"Maui Electric Company, Limited; Notice of Intent; Verification; and Certificate of Service," filed June 9, 2017.

<sup>42</sup>Order No. 35030, "Regarding Completed Application and Other Initial Matters," filed November 20, 2017 ("Order No. 35030").

proceeding. The procedural schedule was subsequently modified by Order Nos. 35333 and 35554.<sup>43</sup>

On February 9, 2018, the commission issued Order No. 35276, which instructed MECO to update its Application with revised schedules that reflect the effects of the federal "Tax Cuts and Jobs Act of 2017" ("2017 Tax Act").<sup>44</sup> The commission subsequently granted MECO an extension of time to comply with Order No. 35276<sup>45</sup> and MECO ultimately filed its revised schedules on February 26, 2018 and February 28, 2018.<sup>46</sup>

Pursuant to the procedural schedule, extensive information requests ("IRs") were issued by the Consumer Advocate and Blue Planet, to which MECO responded.

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<sup>43</sup>See Order No. 35333 at 38-43; and Order No. 35554, "Granting the Parties' Joint Request Filed on June 8, 2018 and Amending the Procedural Schedule," filed June 27, 2018 ("Order No. 35554").

<sup>44</sup>Order No. 35276, "Instructing Maui Electric Company, Limited to Update Application," filed February 9, 2018 ("Order No. 35276").

<sup>45</sup>See Order No. 35308, "Granting Maui Electric Company, Limited's Motion for Enlargement of Time," filed February 26, 2018.

<sup>46</sup>"Maui Electric Company, Limited 2018 Test Year Rate Case; Maui Electric Revised Schedules in Accordance with Order No. 35276; Docket No. 2017-0150," filed February 26, 2018, and supplemented by "Maui Electric Company, Limited; 2018 Test Year Rate Case; Maui Electric Revised Schedules in Accordance with Order No. 35276 and Order No. 35308; Cost of Service and Rate Design," filed February 28, 2018 (collectively, "MECO Revised Schedules").

On April 16, 2018, the Consumer Advocate and Blue Planet submitted their direct testimonies, exhibits, and workpapers.<sup>47</sup>

Pursuant to the Procedural Schedule, MECO also issued IRs to the Consumer Advocate and Blue Planet.

On May 21, 2018, and June 22, 2018, MECO submitted its rebuttal testimonies, exhibits, and workpapers.<sup>48</sup>

On June 8, 2018, the Parties submitted a joint letter request seeking, among other things, an extension of time to submit a settlement agreement and other related procedural deadlines.<sup>49</sup> On June 15, 2018, consistent with the Parties' joint letter request, the Parties submitted the Settlement Agreement.<sup>50</sup> On July 6, 2018, the Parties submitted their Joint Statement of Probable Entitlement.<sup>51</sup>

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<sup>47</sup>CA Direct Testimony; and BP Direct Testimony).

<sup>48</sup>"Maui Electric Company, Limited 2018 Test Year; Rebuttal Testimonies, Exhibits, and Workpapers; Docket No. 2017-0150," filed May 21, 2018 (pertaining specifically to cost of capital); and "Maui Electric Company, Limited 2018 Test Year; Rebuttal Testimonies and Exhibits; Docket No. 2017-0150," filed June 22, 2018 (pertaining to all other areas of rebuttal testimony).

<sup>49</sup>Joint Letter From: J. Viola and Consumer Advocate To: Commission Re: Docket No. 2017-0150 - Maui Electric 2018 Test Year Rate Case; Joint Request for Extension to File Joint Settlement Letter, Filed June 8, 2018.

<sup>50</sup>See Order No. 35554; see also Settlement Agreement.

<sup>51</sup>See Order No. 35554; see also "Maui Electric Company, Limited 2018 Test Year; Parties' Joint Statement of Probable

On June 27, 2018, the commission issued Order No. 35554, granting the Parties' joint letter request and request amending the procedural schedule accordingly. In relevant part, the commission extended the deadlines for the filing of a settlement agreement, statement of probable entitlement, and Rebuttal Testimony and associated IRs.<sup>52</sup> In addition, Order No. 35554 cancelled the Prehearing Conference and Evidentiary hearing, scheduled for July 17, 2018, and July 30 - August 3, 2018, respectively.<sup>53</sup>

On July 31, 2018, MECO submitted proposed revisions to its Schedule P and Schedule J tariff sheets to include a demand ratchet option and the Residential DSM Adjustment and the Commercial Industrial DSM Adjustment of the Integrated Resource Planning Cost Recovery Provision tariff ("Demand Ratchet and DSM Tariffs").<sup>54</sup>

On August 9, 2018, the commission issued Interim Decision and Order No. 35631 ("Interim D&O 35631"), which granted

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Entitlement; Docket No. 2017-0150," filed July 6, 2018 ("Joint Statement of Probable Entitlement").

<sup>52</sup>See Order No. 35554 at 6-7.

<sup>53</sup>Order No. 35554 at 7.

<sup>54</sup>Letter From: D. Matsuura To: Commission Re: Docket No. 2017-0150 - Maui Electric 2018 Test Year Rate Case; Maui Electric Schedule J and P Demand Ratchet Option and DSM Tariff Sheets, filed July 31, 2018.



MECO interim relief in the form of an interim increase in revenues of \$12,481,000, or approximately 3.82% over revenues at current effective rates, consistent with the Parties' Settlement Agreement and Joint Statement of Probable Entitlement. MECO subsequently submitted tariff sheets implementing interim rates, which went into effect on August 23, 2018.<sup>55</sup>

On August 20, 2018, the Parties submitted a letter stating that the Parties have agreed to a ROE of 9.50% and "do not request an evidentiary hearing for this proceeding subject to the conditions explained herein."<sup>56</sup>

E.

Statement Of Issues

Procedural Order No. 35152 set forth the following Statement of Issues to govern this proceeding:<sup>57</sup>

1. Whether MECO's proposed rate increase is reasonable; including, but not limited to:
  - a. Are the revenue estimates for the 2018 test year at current effective rates,

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<sup>55</sup>Letter From: J. Viola To: Commission Re: Docket No. 2017-0150 - Maui Electric 2018 Test Year Rate Case; Maui Electric Interim Increase Tariff Sheets, filed August 21, 2018 ("MECO Interim Rate Tariffs").

<sup>56</sup>Joint Letter From: J. Viola and Consumer Advocate To: Commission Re: Docket No. 2017-0150 - Maui Electric 2018 Test Year Rate Case; Parties' Settlement on ROE and Notification regarding Evidentiary Hearing, filed August 20, 2018 ("ROE Settlement").

<sup>57</sup>Procedural Order No. 35152 at 4-5.

present rates, and proposed rates reasonable?

- b. Are MECO's proposed operating expenses for the 2018 test year reasonable?
  - c. Is MECO's proposed rate base for the 2018 test year reasonable?
  - d. Is MECO's requested rate of return fair?
  - e. Are any adjustments necessary for customers to realize the attendant benefits of MECO's decision to voluntarily forgo a general rate increase in base rates for its mandated 2015 test year?
2. The amount of interim rate increase, if any, to which MECO is probably entitled under HRS § 269-16(d); and
3. Whether MECO's proposed tariffs, rates, charges, and rules are just and reasonable; including, but not limited to:
- a. Is MECO's proposed methodology for allocating costs among its customer classes reasonable?
  - b. Is MECO's rate design for collecting its costs from its customer classes reasonable?
  - c. Are the proposed revisions to the ECAC tariff just and reasonable?
  - d. What changes should be made to separate and remove all test year fuel and purchased energy expenses from base rates, with recovery of these costs to be accomplished through an appropriately modified energy cost adjustment mechanism?
  - e. Are the proposed revisions to the RAM just and reasonable?

With the issuance of Interim D&O 35631, Issue No. 2 has been resolved. Pursuant to the Settlement Agreement, ROE Settlement, and amended procedural schedule, as set forth in Order No. 35554, no further procedural steps are contemplated for the Parties or Participant and the record is ready for decision-making by the commission.

## II.

### DISCUSSION

#### A.

##### The Parties' Settlement Agreement

In Interim D&O 35631, the commission approved the provisions of the Parties' Settlement Agreement. The Settlement Agreement, in turn, resolved many of the issues related to determining MECO's 2018 Test Year revenue requirement and rate design; however, certain issues were expressly deferred for resolution during the remainder of this proceeding.

Specifically, the Settlement Agreement deferred resolution on the following issues:

(A) The appropriate ROE for purposes of determining MECO's final rates;

(B) Proposed modifications to MECO's ECAC, including the risk-sharing mechanism proposed by Blue Planet, changes to MECO's effective target sales heat rates and effective heat rate

deadbands proposed by MECO and the Consumer Advocate, and the separation of fuel and purchased energy costs from base rates;

(C) Cost recovery issues related to Docket No. 2016-0219, pertaining to the Substation Projects, both of which were incomplete but were expected by MECO to be placed in service by the end of 2018;

(D) Cost recovery issues related to Docket No. 2016-0345, involving the deferral and recovery of O&M expenses for the Ma`alaea Project; and

(E) MECO's proposed Demand Ratchet and DSM Tariffs.<sup>58</sup>

The commission addresses each of these deferred issues below.

## B.

### Resolution Of Deferred Issues

#### 1.

#### MECO's ROE

As noted above, pursuant to the ROE Settlement, the Parties have agreed to a ROE of 9.50% for purposes of determining MECO's final rates. This figure reflects the lower end of the range earlier stipulated to by the Parties in the

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<sup>58</sup>See Interim D&O 35631 at 43-54.

Settlement Agreement and also falls within the range provided in the testimonies filed by MECO and the Consumer Advocate.<sup>59</sup>

In addition, the commission observes that a 9.50% ROE was the same ROE approved in the most recent HELCO and HECO rate case proceedings (Docket Nos. 2015-0170 and 2016-0328), the two rate cases preceding MECO in the triennial rate case cycle.<sup>60</sup> While not dispositive of this issue in this proceeding, the commission takes administrative notice of the findings and conclusions in the other HECO Companies' rate case proceedings in this triennial rate case cycle as further indicators of the reasonableness of the Parties' stipulated 9.50% ROE in this proceeding.

In the Settlement Agreement, the Parties have agreed to MECO's 2018 Test Year average capital structure, which: (1) incorporates MECO's actual capital structure balances as of December 31, 2017, and revised estimated change in 2018; and (2) reduces the common equity percentage (and thereby

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<sup>59</sup>See Settlement Agreement at 1 (providing for a stipulated ROE range of 9.75% with a potential reduction up to 25 basis points based on the impacts of decoupling); see also, MECO Direct Testimony, MECO T-21 (Robert B. Hevert); CA Direct Testimony, CA-T-4 (Stephen G. Hill); and MECO Rebuttal Testimony, MECO RT-21 (Robert B. Hevert).

<sup>60</sup>See In re Hawaii Elec. Light Co., Inc., Docket No. 2015-0170, Final Decision and Order No. 35559, filed June 29, 2018, at 66-68; and In re Hawaiian Elec. Co., Inc., Docket No. 2016-0328, Final Decision and Order No. 35545, filed June 22, 2018 ("D&O 35545"), at 40-42.

increases the long-term debt percentage), resulting in a reduced total equity percentage of 58.0%.<sup>61</sup> Applying the Parties' stipulated 9.50% ROE to this capital structure results in an overall 7.43% rate of return on MECO's average test year rate base.<sup>62</sup>

Upon reviewing the record in this proceeding, and considering the circumstances, including the global nature of the Settlement Agreement, and the recently approved ROEs in the preceding HELCO and HECO rate case proceedings, the commission finds that the Parties' stipulation of a 9.50% ROE is the result of earnest and good faith negotiation by the Parties and falls within the range developed and supported by the Parties' testimonies and exhibits. Accordingly, the commission finds that the Parties' stipulated cost of capital, including the average 2018 Test Year capital structure and 9.50% ROE, resulting in an overall rate of return on MECO's average rate base for its 2018 Test Year of 7.43%, is fair and reasonable.

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<sup>61</sup>See Settlement Agreement, Exhibit 1 at 112; and MECO T-22, Attachment 1 (Final Settlement).

<sup>62</sup>See Settlement Agreement, Exhibit 1 at 118; see also, Joint Statement of Probable Entitlement, Attachment 2 at 2.

2.

Blue Planet's Proposed ECAC Modifications

i.

Parties And Positions

In addition to the Parties (MECO and the Consumer Advocate), the commission admitted Blue Planet as a Participant to this proceeding with a limited scope of participation. Specifically, Blue Planet was granted Participant status as it relates to Issue No. 3(c), including whether the proposed revisions to MECO's ECAC are reasonable.<sup>63</sup>

Blue Planet proposes a number of modifications to the ECAC, including: (1) incorporating a risk-sharing feature to incentivize MECO to better manage its fossil fuel use and costs; (2) phasing out fuel cost adjustment provisions for fossil fuel use over the next 25 years; and (3) eliminating the heat rate adjustment of the ECAC.<sup>64</sup>

Blue Planet argues that incorporating a risk-sharing element to the ECAC is consistent with guidance provided by the state Legislature and the commission.<sup>65</sup> Blue Planet proposes several mechanisms for the commission to consider and ultimately

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<sup>63</sup>See Order No. 35333 at 32 and 35.

<sup>64</sup>BP Direct Testimony (Ronald J. Binz) at 7.

<sup>65</sup>See BP Direct Testimony (Ronald J. Binz) at 8-15.

recommends that the commission adopt a risk-sharing mechanism for MECO's ECAC which features a partial pass-through of the variance of utility fuel costs from base costs at a ratio of 5% to the utility and 95% to MECO's customers, with a maximum annual revenue exposure cap of ±\$4.2 million, with the base fuel cost reset annually to the actual fuel cost in the first month of the year.<sup>66</sup>

In Docket No. 2016-0328, Blue Planet proposed a nearly identical risk-sharing proposal for HECO's ECAC, which has been explored and approved, with modifications, by the commission in Docket No. 2016-0328.<sup>67</sup> The commission takes administrative notice of the record in Docket No. 2016-0328, as it pertains to this related issue, including the commission's relevant findings and conclusions.

Blue Planet's witness, Ronald J. Binz, offered several recommendations in Blue Planet's Direct Testimony, including:

1. The commission should modify the ECAC to fairly share the risk between customers and MECO and give MECO "skin in the game" with respect to managing fossil fuel use and costs and moving to renewable energy. I present several potential methods that can be adopted either singly or in combination.

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<sup>66</sup>BP Direct Testimony (Ronald J. Binz) at 23-29.

<sup>67</sup>In Docket No. 2016-0328, the commission approved a risk-sharing mechanism for HECO's ECAC which features a partial pass-through of utility fuel costs at a ratio of 2% to HECO and 98% to HECO's customers, with an annual exposure cap of \$2.5 million. See D&O 35545 at 72-84.



2. In addition to modifying the ECAC to share the risk, the Commission should also adopt a mechanism under which the ECAC for fossil fuels would be phased down over 25 years, by 2042.
3. The commission should eliminate the heat rate adjustment in the ECAC. While such an adjustment was undoubtedly useful at one time, the incentives it provides are not consistent with a move toward deep penetration of variable generation like solar and wind.<sup>68</sup>

Blue Planet identified three options to implement the first two of these recommendations. Summarized briefly:<sup>69</sup>

Option A: "[T]he ECAC could be modified to pass through only part of the increases and decreases of fuel costs."<sup>70</sup>

Option B: "[P]ass through only those increases or decreases that exceed a certain threshold."<sup>71</sup>

Option C: "[C]onsider phasing out the ECAC [for fossil fuels] over 25 years (2017-2042) in a way that doesn't penalize MECO if it continues expeditiously to reduce dependence on fossil fuels. Fossil fuel costs would continue to be an allowable expense, but the ability of the utility to shift fuel cost risk to

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<sup>68</sup>BP Direct Testimony (Ronald J. Binz) at 7.

<sup>69</sup>The following options are also summarized in a table format. See BP Testimony (Ronald J. Binz) at 28.

<sup>70</sup>BP Direct Testimony (Ronald J. Binz) at 23.

<sup>71</sup>BP Direct Testimony (Ronald J. Binz) at 24.

customers through the ECAC would be progressively diminished."<sup>72</sup>

Mr. Binz further noted that:

In the HECO Rate Case [Docket No. 2016-0328], I recommended that the Commission adopt modifications to the ECAC for fossil fuels represented by Options A and C. In response to various Commission IRs inquiring about Option A, Blue Planet further developed and refined the details for such an ECAC sharing mechanism. This recommendation included several main features: (1) sharing or partially passing through changes in utility fuel costs at a ratio of 5% to the utility and 95% to its customers; (2) capping total annual exposure for the utility to ±\$20 million; and (3) annually resetting the base fuel cost, for purposes of calculating the sharing amount, to the actual fuel cost in the first month of the year (or a multi-month average).

In this case, Blue Planet also recommends an ECAC sharing mechanism with these equivalent features for the MECO utility. Blue Planet recommends the same structure with a 5%/95% sharing ratio, and a maximum annual exposure of ±\$4.5 million.<sup>73</sup>

In support of its recommendations, Blue Planet argues that: (a) the commission has previously acknowledged that ECAC provisions may be increasingly at odds with public policy goals and has identified this rate case as a venue for addressing this issue;<sup>74</sup> (b) the Hawaii Legislature has provided policy guidance

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<sup>72</sup>BP Direct Testimony (Ronald J. Binz) at 26.

<sup>73</sup>BP Direct Testimony (Ronald J. Binz) at 28-29.

<sup>74</sup>BP Direct Testimony (Ronald J. Binz) at 8-9.

to promote increased renewable energy generation, reduce reliance on fossil fuels and, with respect to any automatic fuel rate adjustment clause, a mandate to provide incentives to utilities to manage costs and encourage greater use of renewable energy, and to "[f]airly share the risk of fuel cost changes between the public utility and its customers;"<sup>75</sup> and (c) the existing ECAC does not sufficiently address objectives to share risk, manage costs, or increase use of renewable resources.<sup>76</sup>

MECO opposes the ECAC amendments proposed by Blue Planet, arguing that Blue Planet's proposals: (a) incorporate incentives that are "unfairly designed" and would hold MECO responsible for fuel price changes that are not in the Company's control;<sup>77</sup> (b) would increase MECO's business risk and could negatively impact its credit quality;<sup>78</sup> (c) are not consistent with "dollar for dollar" cost pass through practices in a majority of states, and, in those instances in other states where fuel market risk is shared with the utility, risks are smaller than those faced

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<sup>75</sup>BP Direct Testimony (Ronald J. Binz) at 8-11.

<sup>76</sup>BP Direct Testimony (Ronald J. Binz) at 15-22.

<sup>77</sup>MECO Rebuttal Testimony, MECO RT-2 (Joseph P. Viola) at 18 (citing to MECO Rebuttal Testimony, MECO RT-23A (Kurt G. Strunk)).

<sup>78</sup>MECO Rebuttal Testimony, MECO RT-2 (Joseph P. Viola) at 18 (citing to MECO Rebuttal Testimony, MECO RTS-22 (Supplement) (Tayne S. Y. Sekimura)).

by MECO;<sup>79</sup> (d) do not recognize that the existing ECAC provisions sufficiently comply with statutory requirements and that the proposed amendments are not necessary to discourage fossil fuel use and encourage greater use of renewable energy resources;<sup>80</sup> and (e) "[are] too narrowly focused and seem[] to disregard the Companies' [Power Supply Improvement Plan] and Grid Modernization Strategy, the Commission's acceptance of those filings, and stakeholder support for implementation of those plans."<sup>81</sup>

The Consumer Advocate, while not directly addressing Blue Planet's proposed ECAC modifications, appears to oppose Blue Planet's proposal by submitting Direct Testimony that maintains that MECO's existing ECAC can fairly share the risk of fuel cost changes between MECO and its ratepayers, as well as satisfying the other enumerated considerations listed in Act 162,<sup>82</sup> through adjustments to MECO's ECAC deadband and target heat

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<sup>79</sup>MECO Rebuttal Testimony, MECO RT-2 (Joseph P. Viola) at 19 (citing to MECO RT-23A (Kurt G. Strunk)).

<sup>80</sup>MECO Rebuttal Testimony, MECO RT-2 (Joseph P. Viola) at 19-20 (citing to MECO RT-30A (Kurt G. Strunk), MECO RT-8 (Matthew M. McNeff), and MECO RT-9 (Christopher Reynolds)).

<sup>81</sup>MECO Rebuttal Testimony, MECO RT-2 (Joseph P. Viola) at 20-21.

<sup>82</sup>The pertinent considerations of Act 162 addressed by the Consumer Advocate's Direct Testimony are codified in HRS § 269-16(g).

rates.<sup>83</sup> Concomitantly, the Consumer Advocate states that "[b]ecause fuel prices are not within MECO's control . . . it is generally not considered appropriate for MECO to bear the risks of fuel cost changes due to price changes established by a global market."<sup>84</sup>

In the Settlement Agreement, MECO and the Consumer Advocate "recommend that the Commission not adopt or implement Blue Planet's proposed ECAC sharing mechanism."<sup>85</sup> However, the Parties "do support the objective of providing an incentive for Maui Electric to continually reduce its fossil fuel costs[,] and maintain that the State's renewable energy portfolio standards ("RPS") "will force the Company to reduce its reliance on fossil fuels more effectively than a proposal to modify the ECAC to pass through only [a percentage] of fuel price changes."<sup>86</sup> However, as part of the Settlement Agreement, the Parties "agree that Blue Planet's proposed ECAC modifications . . . should be decided by the Commission based on the facts and law submitted in

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<sup>83</sup>See CA Direct Testimony, CA-T-5 (Joseph A. Herz) at 42-48.

<sup>84</sup>CA Direct Testimony, CA-T-5 (Joseph A. Herz) at 43-44.

<sup>85</sup>Settlement Agreement, Exhibit 1 at 15.

<sup>86</sup>Settlement Agreement, Exhibit 1 at 15.

the record and the Parties waive an evidentiary hearing on this matter, subject to the acceptance of this Stipulated Settlement."<sup>87</sup>

ii.

Policy Considerations Regarding Blue Planet's Proposal

As noted in the Parties' testimony and in the record in this proceeding, Blue Planet proposed a substantively identical risk-sharing proposal for HECO's ECAC in HECO's recent rate case, Docket No. 2016-0328.<sup>88</sup> In D&O 35545, the commission provided a thorough discussion of the policy considerations of Blue Planet's proposal, including whether, and to what extent, HECO's then-existing ECAC appropriately and sufficiently complied with the policies and guidance provided by the Hawaii Legislature, particularly as set forth in HRS § 269-16(g).<sup>89</sup> The discussion in D&O 35545 also pertains to the essentially similar testimony and positions of the Parties and Participant in this proceeding.

Briefly, the commission concluded in D&O 35545:

Turning to the examination of what it means to "[f]airly share the risk of fuel cost changes between the public utility and its customers" in [HRS § 269-16] subpart (g)(1), the commission is not convinced by the arguments offered by HECO and the Consumer Advocate that the scope of risks to be "shared" should be

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<sup>87</sup>Settlement Agreement at 1.

<sup>88</sup>See D&O 35545 at 53-88.

<sup>89</sup>See D&O 35545 at 57-72.

limited to only those specific types of risk over which HECO has control. Nothing in subpart (g)(1) suggests that it is intended to address utility actions or performance in any way. Rather, this subpart directly and unconditionally addresses the need to fairly share the risks of fuel cost changes without distinction.

The commission observes that the "risk of fuel cost changes" to be shared in accordance with subpart (g)(1) of the statute is affected both by fluctuations in fuel prices and by the challenges of efficiently operating HECO's system. It is uncontested that the existing ECAC heat rate incentive mechanism "shares" some of the risk associated with the efficiency of operation of HECO's system between the utility and its customers under some circumstances (i.e., under circumstances where heat rates fall outside of the effective heat rate deadbands). That being said, it is also uncontested that the existing ECAC provisions pass essentially all of the risk of fuel price fluctuations to customers. In this sense, the existing ECAC provisions do not share the risk of fuel price changes between the utility and its customers, as HECO does not currently "share" in the risks of fuel price changes.<sup>90</sup>

Accordingly, the commission subsequently concluded:

Although it is challenging to quantify a "fair" sharing of fuel cost risk between the utility and customers, it is evident that the current allocation of 100% fuel price risk to customers is neither fair nor compliant with the letter or intent of the applicable statutory provisions. The commission finds that amending the ECAC to provide for partial adjustment of fuel cost changes is appropriate, reasonable, and consistent with HRS § 269-16(g), provided that the magnitude

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<sup>90</sup>D&O 35545 at 64-65.

of risk sharing is fair and the amount of utility revenue exposure is reasonable.<sup>91</sup>

Ultimately, the commission approved a risk-sharing adjustment for HECO's ECAC, but incorporated a lower percentage of utility risk exposure and a lower maximum annual cap on utility revenue exposure than what was proposed by Blue Planet.<sup>92</sup>

At the same time, the commission declined to implement a phase-out of the ECAC adjustments for fossil fuels in Docket No. 2016-0328 as recommended by Blue Planet, noting that the amount of fossil fuel used by HECO is expected to decrease substantially over the next twenty years in conjunction with HECO's compliance with the existing RPS.<sup>93</sup> In this respect, the commission observed that the existing standards should correspondingly reduce the magnitude and necessity of ECAC adjustments for fossil fuels.<sup>94</sup>

Likewise, the commission did not implement Blue Planet's proposal to eliminate the existing heat rate efficiency incentive provisions in the ECAC.<sup>95</sup> The commission observed that the

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<sup>91</sup>D&O 35545 at 69.

<sup>92</sup>See D&O 35545 at 69 and 72-84 (approving a 2% risk-sharing component with a  $\pm$ \$2.5 million annual revenue exposure cap, rather than the 5% risk-sharing component and \$20 million annual revenue exposure cap proposed by Blue Planet).

<sup>93</sup>See D&O 35545 at 70.

<sup>94</sup>See D&O 35545 at 70.

<sup>95</sup>See D&O 35545 at 70. The target heat rate mechanism has been construed as potentially disincentivizing integration of renewable energy resources, as integrating more renewable energy



deadbands applied to the heat rates in the ECAC already serve to "eliminate" the effect of the heat rate efficiency incentive provisions may have on integrating renewable energy resources within the bounds of the deadbands.<sup>96</sup>

Finally, the commission noted that Blue Planet clarified that its proposed partial ECAC adjustment mechanism could be implemented in conjunction with the existing heat rate efficiency incentive provisions.<sup>97</sup> The commission concluded that elimination of the heat rate efficiency incentive is not warranted at this time and clarified that the commission's approval of a partial ECAC adjustment of fossil fuel expense is intended to complement, not replace, the existing heat rate efficiency mechanism.<sup>98</sup>

The above considerations and conclusions applied on this issue in Docket No. 2016-0328 are fully applicable to Blue Planet's

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typically requires the utility to operate its power plants in a less efficient manner.

<sup>96</sup>D&O 35545 at 70. Within the bounds of the heat rate deadbands, fuel expenses are passed straight through to customers without incentive adjustment. Thus, the utility need not worry about the impact of renewable energy resources on its plant efficiency within the deadband parameters. In its reviews of the bounds of the heat rate deadbands, the commission has allowed progressive increases in the deadbands that decrease the heat rate mechanism effects to a deliberately measured extent, to accommodate changing circumstances in the operation of the utility's system. Id. at 70-71.

<sup>97</sup>D&O 35545 at 70 (citations omitted).

<sup>98</sup>D&O 35545 at 71.

proposal regarding MECO's ECAC and are based on essentially similar testimony and arguments that were presented by MECO, the Consumer Advocate, and Blue Planet in the instant proceeding in support of, and in opposition to, Blue Planet's risk-sharing adjustment. The pertinent testimony and arguments presented in Docket No. 2016-0328 are repeated in the instant rate case proceeding, with MECO providing substantively similar testimony by many of the same witnesses used by HECO.<sup>99</sup> Accordingly, for purposes of this Decision and Order, the commission takes administrative notice of the pertinent discussion, findings, and conclusions in D&O 35545, as well as the relevant portions of the evidentiary record in Docket No. 2016-0328, including the

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<sup>99</sup>Compare In re Hawaiian Elec. Co., Inc., Docket No. 2016-0328, "Hawaiian Electric Company, Inc., 2017 Test Year Supplemental Testimonies, Exhibits and Workpapers," filed February 14, 2018 (including HECO ST-2 (Joseph P. Viola), HECO ST-6 (Nicolas O. Paslay), HECO ST-29 (Tayne S. Y. Sekimura), HECO ST-30 (Peter C. Young), and HECO ST-30A (Kurt G. Strunk)); "Division of Consumer Advocacy's Simultaneous Testimonies and Exhibits Regarding the Amended Statement of Issues," filed February 14, 2018 at CA-ST-5 (Joseph A. Herz); "Blue Planet Foundation's Direct Testimony and Exhibit List; Direct Testimony of Ronald J. Binz; Exhibit 1; and Certificate of Service," filed September 22, 2017; and "Blue Planet Foundation's Amended Testimony and Exhibit List; Supplemental Testimony of J. Binz; and Certificate of Service," filed February 22, 2018 with MECO Rebuttal Testimonies (including MECO RT-2 (Joseph P. Viola), MECO RTS-22 (Tayne S. Y. Sekimura), MECO RT-23 (Peter C. Young), and MECO RT-23A (Kurt G. Strunk)); CA Direct Testimony at CA-T-5 (Joseph A. Herz); and BP Direct Testimony (Ronald J. Binz).

testimony and evidence regarding Blue Planet's proposal provided in that proceeding.

As noted above, the commission concluded that HECO's (then-existing) ECAC did not sufficiently comply with the legislative standards provided in HRS § 269-16(g). Similarly, in this proceeding, the commission finds that MECO's current ECAC does not sufficiently comply with HRS § 269-16(g) for the same reasons. In reaching this conclusion, the commission observes that MECO's ECAC is substantively identical to HECO's and is likewise subject to the same statutory and legislative considerations. Given the similarities between HECO's and MECO's ECACs, as well as the absence of distinguishing circumstances, arguments, or evidence, the commission concludes that it is reasonable to approve a similar risk-sharing adjustment to MECO's ECAC.<sup>100</sup>

However, as discussed further below, and consistent with the commission's action regarding Blue Planet's proposal for HECO in Docket No. 2016-0328, the commission will not adopt Blue Planet's proposed risk-sharing mechanism, in toto, but will

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<sup>100</sup>The commission also notes that implementation of this risk-sharing mechanism is consistent with the policy mandate contained in HRS § 269-6(b) requiring the commission to consider the need to reduce the State's reliance on fossil fuels.

modify the apportionment of revenue exposure and overall annual maximum utility revenue exposure.

iii.

#### Determining The Magnitude Of Partial ECAC Adjustment

In Docket No. 2016-0328, in determining a reasonable percentage of partial adjustment, maximum magnitude of utility revenue exposure, and related implementation details, the commission recognized the need to consider the effectiveness of the partial adjustments with balancing consideration of the potential financial impacts on the Company.<sup>101</sup> Accordingly:

[T]he commission adopts a deliberately conservative and "gradual" approach in determining an appropriate magnitude of revenue exposure, recognizing that: (1) the partial adjustment provisions in the ECAC are a new mechanism for HECO; (2) the proposed changes in revenue exposure are cumulative with other relatively new revenue adjustment mechanisms, such as the Performance Incentive Mechanisms ("PIMs") adopted for the HECO Companies, commencing in calendar year 2018; (3) the proposed changes are being implemented in conjunction with several other modifications to the ECAC in this proceeding, i.e., Amended sub-Issue Nos. 4(b) and (c); (4) the commission expects to broadly examine the implicit and explicit incentives in HECO's regulatory mechanisms in Docket No. 2018-0088 as part of the commission's investigation of performance incentive based regulation; and (5) the initial magnitude of revenue exposure decided in this proceeding is

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<sup>101</sup>See D&O 35545 at 78.

subject to review and amendment, based on experience and changing circumstances in future proceedings.<sup>102</sup>

In determining an appropriate percentage of partial adjustment and maximum annual revenue exposure, the commission examined the results of the analyses of impacts presented by Blue Planet and HECO, in the perspective of and in comparison to the magnitude of other revenue determinations in Docket No. 2016-0328, as well as in comparison to the nature and magnitude of other revenue adjustment mechanisms effective for HECO, including the RBA and RAM mechanisms and the recently approved PIMs.<sup>103</sup>

Specifically, the commission examined the amount of utility revenue exposure resulting from the PIMs currently in effect for all of the HECO Companies and utilized them as a meaningful indicator of a magnitude of revenue exposure previously found to be reasonable for implementing a new incentive mechanism. The magnitude of the maximum revenue exposure of the existing PIMs was carefully considered in Docket No. 2013-0141 and was determined, conservatively, at the lower end of the range of overall financial incentive levels proposed by the HECO Companies and the Consumer Advocate. Given the similarity in circumstances

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<sup>102</sup>D&O 35545 at 78-79 (internal citations omitted).

<sup>103</sup>See Order No. 34514.

and the near identical substantive nature of MECO's ECAC to HECO's ECAC, the commission finds here that it is reasonable to apply a similar approach to determining the appropriate magnitude of utility risk exposure for MECO's ECAC adjustment.

The existing effective portfolio of the three current PIMs for MECO includes two reliability PIMs, each with a maximum revenue exposure (i.e., maximum financial incentive amount) of approximately \$527,289 based on 20 basis points on the common equity share of rate base, and a customer service PIM with a maximum revenue exposure of approximately \$210,916, based on 8 basis points on the common equity share of rate base.<sup>104</sup> Thus, the overall maximum utility revenue exposure of MECO's existing effective portfolio of PIMs is approximately \$1,265,494 per year.<sup>105</sup>

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<sup>104</sup>See MECO Tariff Sheet Nos. 101C, 101D, and 101E. The commission observes that, consistent with the form of the proposals presented in testimony in Docket No. 2013-0141, the maximum financial incentive amount for the PIMs was determined by applying basis points (i.e., hundredths of a percentage point) on the common equity share of effective rate base, without further adjustment for income tax effects. In this respect, the maximum financial incentive amounts determined for the PIMs is directly comparable to the maximum revenue exposure limits considered for partial ECAC adjustments, in the respect that both are stated on a revenue requirement basis. The commission notes that this differs from the conventional characterization of the magnitude of utility performance incentives expressed as percentage basis point impact on the utility rate of return on equity, which is usually expressed as an after-income-tax impact.

<sup>105</sup>As of the effective date of final rates resulting from the final decision and order in this proceeding, the maximum incentive

The commission considered the \$4.2 million maximum revenue exposure limit proposed by Blue Planet in conjunction with the proposed 95% partial adjustment fraction.<sup>106</sup> The commission notes that a \$4.2 million revenue reduction represents an extreme downside possibility associated with the partial adjustment proposed by Blue Planet; in the long run, the average impacts of the partial adjustment would be expected to be substantially smaller than the \$4.2 million maximum exposure and would be just as likely to be a positive, versus a negative, impact.<sup>107</sup>

Nevertheless, in consideration of and comparison to other revenue determinations in this rate case, including MECO's 2018 Test Year operating revenue, ROE share of rate base, settled amounts resolving various rate case issues, and in comparison with other MECO revenue adjustments (particularly the magnitude of the existing effective portfolio of PIMs), the commission finds Blue Planet's proposed maximum revenue exposure limit of \$4.2 million to be too high for an initial implementation of a new revenue adjustment mechanism, especially considering the commission's intent to proceed conservatively. Rather, given that

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amounts in the PIMs will be updated and will increase based on the approved common equity share of the (increased) test year rate base approved in this proceeding.

<sup>106</sup>See BP Direct Testimony (Ronald J. Binz) at 29.

<sup>107</sup>See BP Direct Testimony (Ronald J. Binz) at 30.

this is an initial implementation of a partial adjustment to MECO's ECAC mechanism, the commission finds that the approximately \$1,265,494 magnitude of revenue exposure reflected by the existing portfolio of PIMs represents a reasonable standard to determine the high-end of a range of appropriate revenue exposure. This approach is consistent with the commission's pertinent rulings on the adjustments to HECO's ECAC in Docket No. 2016-0328.<sup>108</sup>

Accordingly, the commission determines that the initial maximum annual revenue exposure limit for MECO's partial ECAC adjustment shall be \$633,000, which equals approximately half the revenue exposure resulting from the overall portfolio of existing PIMs. In conjunction with this initial level of maximum revenue exposure, the commensurate initial percentage fraction of partial adjustment shall be 98%, along with annual "resetting" of the benchmark fuel costs around which partial adjustments are determined.<sup>109</sup>

While significantly less than the amounts proposed by Blue Planet, this amount of revenue exposure is still expected to

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<sup>108</sup>See D&O 35545 at 79-84.

<sup>109</sup>Using the analysis models provided by Blue Planet, the commission determined that a 98% partial adjustment fraction would be limited by a \$632,747 cap in three out of the ten-year 2008-2017 historical period, assuming annual "reset" of the ECAC fuel cost benchmark. See Blue Planet response to PUC-IR-1(b) and supporting spreadsheets, filed August 31, 2018.



share some of the risk of fuel cost changes with MECO, thereby enhancing MECO's strategic level of attention, diligence, and motivation to manage and avoid the costs and risks of fossil fuels, while remaining substantially below an amount that will negatively impact MECO's financial integrity, and well below an amount that will affect MECO's 2018 Test Year ROE. In addition, the commission plans to review and re-examine the amount of maximum revenue exposure and the partial percentage adjustment fraction in future proceedings and as circumstances warrant.

In addition, the commission notes that MECO's fuel consumption is divided among its Maui, Lanai, and Molokai Divisions.<sup>110</sup> Accordingly, the commission has apportioned the fuel-risk sharing mechanism cap among each of MECO's Divisions based on the approximate proportions of fuel expense. Based on the approved 98%/2% split of ratepayer to company exposure, and resulting ±\$633,000 annual maximum cap for MECO, the maximum exposure cap for each of MECO's Divisions shall be as follows: \$570,000 for Maui Division, \$31,500 for Lanai Division, and \$31,500 for Molokai Division.

As noted in Docket No. 2016-0328 regarding the modifications to HECO's ECAC, the modifications to MECO's ECAC

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<sup>110</sup>This issue was not present in Docket No. 2016-0328, as HECO has only one operating division.

providing only partial pass-through of changes in fuel costs pertain only to fossil fuel expense associated with operation of MECO's generation facilities and shall not affect the full adjustment and pass-through of purchased energy expense.<sup>111</sup>

Based on the above, the commission finds that implementation of the partial adjustment of ECAC revenues shall commence with the implementation of the ECRC mechanism, pursuant to this Final Decision and Order, or as otherwise ordered by the commission. Further instructions regarding the implementation of the partial adjustment to the ECAC are discussed below.

iv.

Review And Approval Of The ECRC Tariff

According to the Settlement Agreement, the Parties' stipulated changes to MECO's ECAC include: (1) modified effective target sales heat rates for MECO's divisions (Maui, Lanai, and Molokai); (2) amended language regarding interim redetermination of target sales heat rates; (3) modified effective heat rate deadbands; (4) improved exchange of data and more frequent

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<sup>111</sup>See D&O 35545 at 65-66 (including n.166), 76-77 and 178.

reporting by MECO; (5) and adoption of the energy-expense separation approach proposed by HECO in Docket No. 2016-0328.<sup>112</sup>

Specifically, regarding item (5), above, the Parties state:

For purposes of reaching a settlement, the Parties agree to implement the energy-expense separation approach described in Hawaiian Electric's responses to CA-IR-600, CA-IR-601, CA-IR-602, and CA-IR-603 filed on January 29, 2018 in the Hawaiian Electric 2017 test year rate case, Docket No. 2016-0328. The Parties agree to implement the energy-expense separation three months after final rates in this rate case go into effect, and that it implement the energy-expense separation in a manner such as to have no impact: 1) on revenue allocation and cost-of-service established for the rate classes; and 2) on effective rates per billed kW and per billed kWh and on individual customer bills.<sup>113</sup>

In Interim D&O 35631, the commission accepted, for interim purposes, the Parties' Settlement Agreement ECAC modifications, but deferred final ruling on the stipulated proposed modifications to MECO's ECAC, observing that: (1) similar stipulated conditions to HECO's ECAC were then under review by the commission in Docket No. 2016-0328; and (2) the commission intended to continue analyzing Blue Planet's proposed risk sharing

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<sup>112</sup>Settlement Agreement, Exhibit 1 at 12-14.

<sup>113</sup>Settlement Agreement, Exhibit 1 at 14 (internal citations omitted).

adjustment to MECO's ECAC during the remainder of this proceeding.<sup>114</sup>

Since Interim D&O 35631 was issued, the commission has concluded its review of HECO's ECRC tariff in Docket No. 2016-0328, including resolution of the various issues pertaining to the adjustment to the target heat rates and deadbands, as well as language implementing a risk-sharing mechanism based on Blue Planet's proposal (which mirrors Blue Planet's proposal in this proceeding).<sup>115</sup> Many of the commission's initial concerns regarding the Parties' stipulated changes to HECO's ECAC were resolved through review of HECO's proposed ECRC tariff, an informal technical conference (in which HECO, the Consumer Advocate, Blue Planet, and commission staff participated), and subsequent briefing on the proposed tariff.<sup>116</sup>

As a result, the commission approved a new ECRC tariff for HECO, which replaced HECO's ECAC tariff. HECO's new ECRC tariff continues, in practice, to operate with the same result as the ECAC; however, with the notable exceptions that the ECRC: (1) incorporates the commission's approved risk-sharing adjustment

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<sup>114</sup>Interim D&O 35631 at 45-47.

<sup>115</sup>See Order No. 35927, "Addressing Hawaiian Electric Company, Inc.'s Revised Energy Cost Recovery Clause and Related Tariff Sheets, Filed October 16, 2018 and November 8, 2018," filed December 7, 2018 ("Order No. 35927").

<sup>116</sup>See Order No. 35927.

pertaining to the partial adjustment of fossil fuel expenses; (2) effectuates the separation of energy expenses from base rates with recovery solely through the ECRC; and (3) implements various stipulated changes to the target heat rates, deadbands, and related matters (e.g., re-determination of target heat rates and deadbands in between general rate cases).

Upon considering the circumstances, including the resolution of many of the outstanding ECAC issues through review and approval of the tariff language of HECO's ECRC in Docket No. 2016-0328, and the commission's findings regarding Blue Planet's proposal, noted above in Sections II.B.2.ii (Policy Considerations Regarding Blue Planet's Proposal) and iii (Determining The Magnitude Of Partial ECAC Adjustment), the commission instructs MECO to submit a proposed ECRC tariff within thirty (30) days of this Decision and Order. In preparing its proposed ECRC tariff, the commission encourages MECO to look to Docket No. 2016-0328 for guidance and example, as HECO developed a similar tariff in that proceeding which addressed nearly identical issues and was ultimately approved by the commission.<sup>117</sup>

Following MECO's submission of its draft ECRC, the Consumer Advocate and Blue Planet will have fifteen (15) days to review the draft and submit comments on MECO's draft ECRC to

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<sup>117</sup>See Order No. 35927.

the commission. Following the submission of comments by the Consumer Advocate and/or Blue Planet, if any, MECO may submit reply comments to the commission within seven (7) days of receipt of the Consumer Advocate's and/or Blue Planet's comments. After the receipt of all timely comments, the commission will render a decision on MECO's proposed ECRC tariff, including an effective date.

In the Settlement Agreement, the Parties agreed to implement the ECRC within "three months after final rates in this rate case go into effect[.]"<sup>118</sup> The Parties, Blue Planet, and the commission will endeavor to meet this proposed implementation schedule; however, the commission notes that the presence of a number of variable factors, including the review and approval of MECO's final rate tariffs (including effective date), the timeliness of the Parties' and Blue Planet's comments regarding MECO's proposed ECRC tariff, and the extent and nature of any disagreements, if any, on MECO's ECRC tariff may prolong the time needed to resolve this issue. To the extent circumstances result in delay which makes the Parties' proposed implementation schedule impractical, the Parties may propose a modified implementation schedule for the commission's consideration.

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<sup>118</sup>Settlement Agreement, Exhibit 1 at 14.

Cost Recovery Issues Related To Docket No. 2016-0219

On August 25, 2016, MECO submitted an application in Docket No. 2016-0219 requesting approval to recover through the RAM, above the 2017 RAM Cap, revenue requirements associated with net plant additions for the Ka'ono'ulu Project and the Kuihelani Project, both of which MECO expected to be completed and placed in service in 2018.<sup>119</sup>

On February 15, 2018, in response to CA-IR-256 filed in this proceeding, MECO estimated that the expected in-service date for the Kuihelani Project was September 2018 and the expected in-service date for the Ka'ono'ulu Project was December 2018.<sup>120</sup> Accordingly, the Parties' Settlement Agreement includes estimated plant additions and expenses associated with these Substation Projects in MECO's 2018 Test Year.

On July 25, 2018, the commission issued Order No. 35602 in Docket No. 2016-0219, in which the commission dismissed MECO's

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<sup>119</sup>See In re Maui Electric Company, Ltd., Order No. 35602, "Dismissing Maui Electric Company, Limited's Application Without Prejudice," filed July 25, 2018 ("Order No. 35602"), at 4. MECO had previously received commission approval to commit funds in excess of \$2,500,000 for both Projects. See Docket Nos. 2015-0070 and 2015-0071.

<sup>120</sup>MECO response to CA-IR-256, filed February 15, 2018. The HECO Companies reiterated these expected in-service dates in their 2018 First Quarter Capital Project Status Report, Attachment 11 at 3, filed with the commission on May 31, 2018.

application without prejudice. In doing so, the commission noted, in relevant part:

Several developments related to the Substation Projects have occurred since MECO originally filed its Application on September 25, 2016, including the delay in putting the Substation Projects into service, the establishment of the MPIR Guidelines, and the filing of MECO's 2018 Test Year rate case. As a result, the commission finds that, in the interest of promoting administrative efficiency and to avoid the duplication of effort, and, given MECO's subsequent statements in Docket No. 2017-0150 that it is still "evaluating its options for the recovery of these capital projects," the issue of cost recovery for the Substation Projects should be addressed in the ongoing MECO rate case (Docket No. 2017-0150), rather than in the instant docket.<sup>121</sup>

Shortly thereafter, on August 9, 2018, in Interim D&O 35631, the commission identified cost recovery for the Substation Projects in MECO's 2018 Test Year as a deferred issue for continued examination in this proceeding, including confirming the actual in-service dates for the Projects (i.e., whether they

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<sup>121</sup>Order No. 35602 at 13 (citing MECO Direct Testimony, MECO-209 at 6). The "MPIR Guidelines" refer to "Major Project Interim Recovery" ("MPIR") Guidelines that were established in Docket No. 2013-0141, the commission's investigation to re-examine the HECO Companies' decoupling mechanism. See In re Public Util. Comm'n, Docket No. 2013-0431, Order No. 34514, "Establishing Performance Incentive Measures and Addressing Outstanding Schedule B Issues," filed April 27, 2017, Attachment A ("MPIR Guidelines"). The MPIR Guidelines, in turn, set forth the process by which the commission reviews applications for interim recovery of Major Project costs in between general rate cases through the MPIR adjustment mechanism.



are placed in-service during the 2018 Test Year as expected), as well as other issues related to cost recovery for the Projects.<sup>122</sup>

On October 15, 2018, in response to PUC-MECO-IR-3, MECO provided an update as to the estimated Substation Projects' completion dates. Regarding the Kuihelani Project, MECO confirmed that three of the four Project components had been placed into service: (1) M0000107, Kuihelani Substation; (2) M0001304, Kuihelani T&D; and (3) M0001305, Kuihelani Communication. Regarding the fourth and final component of the Kuihelani Project, M0001977, the Kuihelani Substation Land component, MECO stated that it expected it to be acquired and placed into service in December 2018 and would "inform the Commission of any changes to the timing of the substation land purchase."<sup>123</sup>

However, regarding the Ka`ono`ulu Project, MECO clarified that only one of the Project's three components, M0001890, the Ka`ono`ulu Substation Land/Easement component, had been placed into service, and that the remaining components, M0001051, Ka`ono`ulu Substation T&D Feeder, and M0001039, Ka`ono`ulu Substation, were expected to be placed into service in

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<sup>122</sup>See Interim D&O 35631 at 47-49.

<sup>123</sup>MECO response to PUC-MECO-IR-3, filed October 15, 2018, at 1-2.

February 2019 and June 2019, respectively.<sup>124</sup> Notwithstanding the delayed timeframe for placing the various Project components in service, MECO clarified that "[a]ll three projects [i.e., components] were included in the end of year rate base balance in determining the 2018 test year revenue requirements, which were based on the Company's best estimates and assessment at the time."<sup>125</sup> MECO stated that "[t]he delay in the completion of these [components] is primarily driven by the longer than expected time to negotiate and execute a perpetual, exclusive easement with the option of purchasing the underlying land in fee upon final subdivision approval[,] " which MECO stated "are necessary before any construction of the substation can begin."<sup>126</sup>

Subsequently, on January 11, 2019, in response to additional commission IRs, MECO clarified that the Kuihelani Substation Land component, M0001977, had not been placed into service in December 2018, and was not expected to be completed until the "second quarter of 2019."<sup>127</sup> In response to how this

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<sup>124</sup>MECO response to PUC-MECO-IR-3, filed October 15, 2018, at 2.

<sup>125</sup>MECO response to PUC-MECO-IR-3, filed October 15, 2018, at 2-3.

<sup>126</sup>MECO response to PUC-MECO-IR-3, filed October 15, 2018, at 3.

<sup>127</sup>MECO response to PUC-MECO-IR-6, filed January 11, 2019, at 1.

delay should affect regulatory treatment of the Kuihelani Substation Land component's associated costs, MECO stated that its preference is for the test year cost of the land to remain in the test year rate base, as reflected in the Settlement Agreement, but allowed that:

Given the circumstances that can potentially extend the timing of acquiring the subject property and completing the Kuihelani Substation Land [component], and assuming the Commission is so inclined, the Company will remove \$896,000 from the end of test year plant in service balance. (The Company did not include the land in the beginning of test year plant in service balance.) This would lower the test year revenue requirement by approximately \$46,000. The only item affected would be the amount of the Kuihelani Substation Land [component]. There would be no impact on the accumulated deferred income taxes [{"ADIT"}] or [CIAC] or depreciation or amortization expense.<sup>128</sup>

Thereafter, the commission issued additional IRs to MECO to ascertain the "used and useful" status of the Substation Projects during the 2018 Test Year. In response, MECO clarified that the Kuihelani Substation component (M0000107), the Kuihelani T&D component (M0001304), and the Kuihelani Communication component (M00013058) are "operating and actively used in providing electrical services to customers."<sup>129</sup> MECO further

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<sup>128</sup>MECO response to PUC-MECO-IR-6 at 2.

<sup>129</sup>MECO response to PUC-MECO-IR-7, filed January 25, 2019, at 4.

clarified that "[t]he status of the Kuihelani [Substation] Land [component] (M0001977) . . . does not affect the Company's ability to provide electrical services to customers and it does not impact the above-discussed projects' ability to be used and useful in providing electrical services to the Company's customers."<sup>130</sup> Notwithstanding the unresolved nature of the Kuihelani Substation Land component, MECO explained "[b]ecause Maui Electric has a legal right (through a right-of-entry) to currently locate and operate the substation and its related equipment on the property, the status of the land acquisition does not impact the Company's ability [to] provide electrical service."<sup>131</sup>

In addition, the Companies clarified that the estimated in-service date for the Ka`ono`ulu Substation T&D Feeder component of the Ka`ono`ulu Project has been delayed from February 2019 to June 2019.<sup>132</sup> As a result, only the Ka`ono`ulu Substation Land/Easement component (M0001890) was placed in service during the 2018 Test Year, with the Ka`ono`ulu Substation and T&D Feeder components of the Ka`ono`ulu Project not expected to be placed in service until June 2019.<sup>133</sup>

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<sup>130</sup>MECO response to PUC-MECO-IR-7 at 5.

<sup>131</sup>MECO response to PUC-MECO-IR-7 at 5.

<sup>132</sup>MECO response to PUC-MECO-IR-7 at 6.

<sup>133</sup>See MECO response to PUC-MECO-IR-7 at 5-6.

As stated by the Hawaii Supreme Court: "[a] public utility is allowed 'a fair return on the property of the utility actually used and useful for public utility purposes.'" <sup>134</sup> Applying this to the Kuihelani Project, the Kuihelani Substation, T&D, and Communication components were all placed in service before or during the 2018 Test Year and are "actively used in providing electrical services to customers." <sup>135</sup> Furthermore, the operation of these Kuihelani Project components does not appear to be affected by the incomplete nature of the Kuihelani Substation Land component, as MECO has a right-of-entry to locate and operate the substation and its related equipment on the property. <sup>136</sup> Accordingly, the commission concludes that the Kuihelani Substation (M0000107), T&D (M0001304), and Communication (M0001305) components of the Kuihelani Project were all placed in service and are considered "used and useful" during the 2018 Test Year <sup>137</sup> and, therefore, may be included in MECO's 2018 Test Year.

As for the Kuihelani Substation Land component (M0001977), it is undisputed that this transaction was not

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<sup>134</sup>In re Puhi Sewer & Water Company, Inc., 83 Hawaii 132, 137, 925 P.2d 302, 307 (1996) (citing HRS § 269-16(b)).

<sup>135</sup>MECO response to PUC-MECO-IR-7 at 4.

<sup>136</sup>See MECO response to PUC-MECO-IR-7 at 5.

<sup>137</sup>See MECO response to PUC-MECO-IR-3, filed October 15, 2018 at 1 (noting that the Kuihelani Substation, T&D, and Communications were all placed in service before or during the 2018 Test Year).

completed during the 2018 Test Year.<sup>138</sup> Consequently, the commission finds that it was not used and useful during the 2018 Test Year and its associated costs should be removed from MECO's 2018 Test Year. The commission observes that MECO does not appear averse to this course of action, as MECO proposed such an adjustment in its response to PUC-MECO-IR-6 with its offer to remove \$896,000 from the end of its 2018 Test Year plant in service balance<sup>139</sup> (however, as discussed below, the commission will allow MECO interim recovery of the Kuihelani Substation Land component when it is completed and placed in service). Furthermore, pursuant to HRS § 269-16(d), MECO shall refund to its customers those amounts that are associated with the Kuihelani Substation Land component that MECO collected through interim rates.

Regarding the Ka'ono'ulu Project, only the Ka'ono'ulu Substation Land/Easement component of the Project was completed during the 2018 Test Year,<sup>140</sup> while the remaining components, the Ka'ono'ulu Substation (M0001039) and Ka'ono'ulu Substation T&D

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<sup>138</sup>See MECO response to PUC-MECO-IR-6.

<sup>139</sup>See MECO response to PUC-MECO-IR-6.

<sup>140</sup>See MECO response to PUC-MECO-IR-3 at 2. MECO states that the Ka'ono'ulu Substation Land/Easement component was "placed in service" in September 2018. As noted below, while the commission does not contest that the Substation Land/Easement component was completed in 2018, this does not necessarily equate to being "placed in service," for purposes of regulatory cost recovery, which is a specific term of art that involves a corresponding finding of being "used and useful" for ratepayers.

Feeder (M0001051), are not expected to be placed in service until June 2019.<sup>141</sup> Consequently, no electrical services were provided to MECO's customers by the Ka`ono`ulu Project during the 2018 Test Year. As a result, the commission finds that the costs associated with the Ka`ono`ulu Project, in its entirety, should be removed from MECO's 2018 Test Year.

While MECO maintains that the Ka`ono`ulu Substation Land/Easement component was placed in service during the 2018 Test Year and "has been utilized for its intended purpose[,]"<sup>142</sup> the commission does not find this argument persuasive. It is unclear as to what the Ka`ono`ulu Substation Land/Easement component's "intended purpose" is and how this purpose, by itself, can be construed as "used and useful" by MECO's customers. Based on the record before the commission, the Ka`ono`ulu Substation Land/Easement component's sole purpose is to provide a physical location upon which to construct the Ka`ono`ulu Substation and auxiliary facilities, which, in turn, will provide electrical services to customers. However, absent an operating substation atop the property, the property itself does not appear to provide any intrinsic "used and useful" value or

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<sup>141</sup>See MECO response to PUC-MECO-IR-7 at 5-6.

<sup>142</sup>MECO response to PUC-MECO-IR-7 at 5.

service to MECO's customers and, thus, should be excluded from MECO's 2018 Test Year.<sup>143</sup>

In the Settlement Agreement, the Parties included the Ka'ono'ulu Project in MECO's 2018 Test Year.<sup>144</sup> Consistent with the discussion above, the commission finds that these Project costs should be removed from the 2018 Test Year, as the Ka'ono'ulu Project was not used and useful during the 2018 Test Year. Furthermore, as the Ka'ono'ulu Project costs were included in MECO's revenue requirement for purposes of determining interim rates, MECO shall refund to its customers those revenues collected through interim rates that are associated with the Ka'ono'ulu Project, including interest on collected balances, pursuant to HRS § 269-16(d).

That being said, the commission acknowledges MECO's assertion that removing the Ka'ono'ulu Project from its 2018 Test Year, without some further allowance, could result in limited revenue recovery due to the effects of MECO's RAM Cap and could

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<sup>143</sup>In contrast, regarding the Kuihelani Substation Project, the substation components necessary to provide electrical services to MECO's customers were completed and began actually providing electrical services during the 2018 Test Year. To the extent the Land component is currently incomplete, this did not impair the substation's ability to begin providing electrical service, as MECO had a right-of-entry that permitted it to operate the substation on the property.

<sup>144</sup>See MECO response to PUC-MECO-IR-3 at 2-3.



therefore have an impact on MECO's finances during the interim years before its next scheduled general rate case.<sup>145</sup> However, the commission does not agree to MECO's proposed methods for interim revenue recovery for the Ka'ono'ulu Project. First, as stated above, the commission finds that the Project's costs should not be recovered through base rates, as the Project was not used and useful during the 2018 Test Year. Consequently, the commission does not find that MECO's proposal to include the Ka'ono'ulu Project costs in base rates is appropriate.<sup>146</sup>

Second, the commission does not find that recovery through the MPIR adjustment mechanism is appropriate under the circumstances. As set forth in the MPIR Guidelines, interim relief through the MPIR adjustment mechanism is intended to be considered on a case-by-case basis in conjunction with review of Major Projects pursuant to the commission's General Order No. 7 ("G.O.7").<sup>147</sup> In this instance, the Ka'ono'ulu Project has already completed the G.O.7 process and was expected to go into service during the 2018 Test Year. Accordingly, the unexpected issue of

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<sup>145</sup>See MECO response to PUC-MECO-IR-3.

<sup>146</sup>See MECO response to PUC-MECO-IR-3 at 5-6. However, as noted above, the commission does find that a refund of the Project costs recovered through MECO's interim rates is necessary.

<sup>147</sup>See MPIR Guidelines at 2, Section II.B.3 (Cost Recovery Issues Related To Docket No. 2016-0219).

interim cost recovery now facing the commission is a separate and distinct matter.<sup>148</sup>

That being said, the commission will allow MECO a specific means for interim recovery for the excluded costs associated with the Ka`ono`ulu Project and the Kuihelani Substation Land component. As noted above, MECO anticipates financial hardship if the substation is subsequently placed in service without any means for interim cost recovery beyond the normal operation of the RAM. While the commission disagrees with the specific means of interim recovery proposed by MECO, MECO should not bear the financial hardships resulting from what appear to be unexpected Project delays. As a result, the commission will allow MECO to recover costs for the Ka`ono`ulu Project and Kuihelani Substation Land component (1) through the operation of the RAM, (2) with the specific provision that RAM adjustment revenues for the Project will be unlimited by and excluded from the determination and application of the RAM Cap, and (3) with full refund to customers of revenues

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<sup>148</sup>While the commission has, under other circumstances, considered and/or approved interim recovery under the MPIR adjustment mechanism for projects that had already received G.O. 7 approval at the time of the request, see e.g., In re Hawaiian Electric Company, Inc., Docket No. 2017-0213, such consideration was based on the unique circumstances of that project, and was implemented through a subsequent process including filing and review of supporting evidence pursuant to the MPIR Guidelines.

accrued and/or collected through interim rates. This should allow MECO to appropriately and timely recover the Ka`ono`ulu Project and Kuihelani Substation Land component's costs without requirements and further proceedings pursuant to the MPIR Guideline provisions, and avoid the negative financial impacts asserted by MECO due to the normal implementation of the RAM Cap.

In providing this relief, the commission emphasizes that requests for interim revenue recovery are reviewed on a case-by-case basis and that the determinations are based on the unique circumstances of each project.

Based on the above, the commission finds that the Kuihelani Substation Land component and the Ka`ono`ulu Project were not used and useful during the 2018 Test Year. Accordingly, MECO shall collaborate with the Consumer Advocate to develop and submit revised schedules of operations which remove these costs from its 2018 Test Year revenue requirement within thirty (30) days of this Decision and Order.

Additionally, as discussed in further detail in Section II.D (HRS § 269-16(d) Statutory Refund Provision), below, MECO shall provide a refund of any revenues accrued and/or collected that are associated with the Ka`ono`ulu Project and Kuihelani Substation Land component through interim rates, including interest on collected balances at the rate of return on

rate base in accordance with HRS § 269-16(d), and return of any accrual of interest on RBA balances at the rate of interest on RBA balances.

As provided in MECO's RAM Provision tariff, if a project is put in service prior to October 1, 2019, MECO may accrue and recover revenues for the project for the 2019 RAM Period commencing June 1, 2019. Recovery shall be in accordance with the normal operation of the RAM with the exception that revenues for the project shall not be subject to limitation by the RAM Cap and shall not be included in the determination or application of the RAM Cap.

4.

Cost Recovery Issues Related To Docket No. 2016-0345

As discussed in Interim D&O 35631, the Parties have reached an agreement regarding approximately \$2,536,176 in deferred O&M expenses and approximately \$2,921,250 in capital costs for the Ma`alaea Project.<sup>149</sup> Specifically, the commission noted that MECO filed an application in Docket No. 2016-0345 seeking approval to: (1) defer the Ma`alaea Project's O&M expenses from the date of the application; and (2) recover the Ma`alaea Project's actual deferred and capital costs through the

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<sup>149</sup>See Interim D&O 35631 at 49-52.

Renewable Energy Infrastructure Program ("REIP") surcharge until such costs could be included in MECO's base rates.<sup>150</sup> The commission further noted that MECO subsequently filed a motion in Docket No. 2016-0345 seeking alternative approval to recover the capital costs for the Ma`alaea Project through the MPIR adjustment mechanism instead.<sup>151</sup>

Pursuant to the Settlement Agreement, the Parties have agreed that MECO will: (1) include the capital costs for the Ma`alaea Project in its 2018 Test Year rate base and withdraw its request for recovery of these capital costs under either the REIP surcharge or the MPIR adjustment mechanism in Docket No. 2016-0345; and (2) remove the Ma`alaea Project's O&M deferred average cost balance of \$2,357,000 from the 2018 Test Year, pending a decision in Docket No. 2016-0345.<sup>152</sup> As a result, the Parties have included an adjustment to MECO's Production O&M expenses to remove \$642,000 in amortization expenses for the Ma`alaea Project for the 2018 Test Year, for the purpose of interim rates.<sup>153</sup>

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<sup>150</sup>Interim D&O 35631 at 49. See also, Settlement Agreement, Exhibit 1 at 49.

<sup>151</sup>Interim D&O 35631 at 49-50.

<sup>152</sup>See Settlement Agreement, Exhibit 1 at 51 and 106.

<sup>153</sup>See Settlement Agreement, Exhibit 1 at 51.

In Interim D&O 35631, the commission accepted the Parties' stipulation on this issue for interim purposes.<sup>154</sup> In particular, the commission stated that it would "take administrative notice of the events in Docket No. 2016-0345, including monitoring whether MECO withdraws its REIP and MPIR cost recovery requests and whether, and to what extent, approval for the Ma`alaea Deferred Costs is granted."<sup>155</sup>

Since the filing of the Settlement Agreement, MECO has withdrawn its request to recover the Ma`alaea Project's capital costs through the REIP surcharge or the MPIR adjustment mechanism.<sup>156</sup> Additionally, the commission has issued D&O 36159 in Docket No. 2016-0345 granting MECO's request to defer its O&M expenses for the Ma`alaea Project. Pursuant to D&O 36159, MECO may include \$2,460,000 of O&M expenses for the Ma`alaea Project in its 2018 Test Year, amortized over a five-year period.<sup>157</sup> This is intended to fully amortize the Ma`alaea Project's O&M expenses prior to MECO's 2024 test year.<sup>158</sup>

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<sup>154</sup>Interim D&O 35631 at 52.

<sup>155</sup>Interim D&O 35631 at 52.

<sup>156</sup>See In re Maui Elec. Co. Ltd., Docket No. 2016-0345, Order No. 35868, "Approving Withdrawal of Motion for Leave," filed November 5, 2018 ("Order No. 35868").

<sup>157</sup>See D&O 36159 at 9-10.

<sup>158</sup>See D&O 36159 at 9.

However, the commission expressly precluded MECO from including the unamortized balance of the Ma`alaea Project's expenses "in rate base or otherwise allow[ing] the accrual of any carrying charge."<sup>159</sup> Accordingly, MECO may include approximately \$492,000 in amortized expenses for the Ma`alaea Project its 2018 Test Year,<sup>160</sup> but shall not include the unamortized balance in the test year rate base or otherwise accrue any carrying charge on the unamortized balance.

Based on the above, MECO shall submit revised schedules of operations which incorporate the approved amortized deferred O&M expenses into MECO's 2018 Test Year. As noted above, MECO has already been instructed to collaborate with the Consumer Advocate to develop and submit revised schedules of operations removing the Kuihelani Substation Land component costs and the Ka`ono`ulu Project costs within thirty (30) days of this Decision and Order. The Parties shall include in these revised schedules the necessary adjustments to incorporate the Ma`alaea Project's amortized O&M expenses into MECO's 2018 Test Year, consistent with the rulings herein and in D&O 36159.

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<sup>159</sup>D&O 36159 at 9.

<sup>160</sup> $\$2,460,000 / 5 \text{ years} = 492,000.$

Schedule J And P Demand Ratchet Options And DSM Tariffs

Regarding MECO's proposed Demand Ratchet and DSM Tariffs, the commission now approves them in their entirety. In Interim D&O 35631, the commission noted that it had not had sufficient time to review the Demand Ratchet and DSM Tariffs prior to issuing Interim D&O 35631, given the statutory deadline of August 13, 2018, but would continue to examine this issue during the remainder of this proceeding.<sup>161</sup>

## i.

Schedule J And P Demand Ratchets

Regarding MECO's demand ratchets, the Parties agree to "make available a once-per-year billing demand ratchet adjustment option for Schedule J and P customers to have their billing demand ratchet reduced by the effect of the installation of documented energy efficiency measures installed by the customer, with a 4-month window from implementation to apply for the ratchet adjustment."<sup>162</sup> Subsequent to the Settlement Agreement,

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<sup>161</sup>Interim D&O 35631 at 52-53.

<sup>162</sup>Settlement Agreement, Exhibit 1 at 125-26.



MECO submitted proposed revisions to its Schedule J and Schedule P tariffs implementing the Parties' stipulated revision.<sup>163</sup>

Upon review, the commission finds MECO's proposed revisions to its Schedule J and Schedule P tariffs reasonable. As stated in Interim D&O 35631, "the commission supports the inclusion of opportunities for Schedules J and P customers to have their billing demand ratchet reduced through the use of demand-reducing measures in addition to energy efficiency," which MECO's revised Schedule P and Schedule J tariffs appear to provide. By allowing Schedule P and Schedule J customers to make an adjustment during the year in response to the installation of energy efficiency measures, customers will have the opportunity to reduce their demand ratchets.

ii.

DSM Tariff

MECO's Demand Ratchet and DSM Tariffs also proposed changes to its DSM tariff to terminate cost recovery of monthly incentive payments for MECO's Fast DR Program through the DSM Surcharge, consistent with the Parties' stipulation for MECO to include its recurring Fast DR Program costs in base rates.<sup>164</sup>

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<sup>163</sup>See Demand Ratchet and DSM Tariffs.

<sup>164</sup>See Demand Ratchet and DSM Tariffs at 2. As noted above, in the Settlement Agreement, the Parties agreed to include \$699,000

Specifically, the Parties agreed to remove certain DR cost forecast estimates for "programs that had been approved by the Commission but [have] not [been] fully implemented by MECO or materially subscribed by customers."<sup>165</sup> However, the Parties agreed to allow MECO to recover \$699,000 in "incentive costs" associated with its Fast DR Program through the DSM Surcharge, until the commission incorporates them into interim or final rates.<sup>166</sup>

In the Demand Ratchet and DSM Tariffs, MECO proposed revisions to its DSM tariff that will result in "[t]he termination of cost recovery of the monthly incentive payments for the Fast DR Program through the DSM Surcharge [to] coincide[] with the effective date of their inclusion in base rates . . . ."<sup>167</sup>

Upon review, the commission finds the Parties' stipulation on this issue to be reasonable. To the extent MECO's

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for MECO's existing Fast DR Program and commission-approved Fast DR Program expansion as part of MECO's 2018 Test Year Customer Service O&M expenses. See Settlement Agreement, Exhibit 1 at 62-65.

<sup>165</sup>See Settlement Agreement, Exhibit 1 at 64 (citing CA Direct Testimony, CA-T-1 (Steven C. Carver) at 68).

<sup>166</sup>See Settlement Agreement, Exhibit 1 at 59 and 65 (corrected June 21, 2018).

<sup>167</sup>Demand Ratchet and DSM Tariffs at 2. See also, id. at 1 n.4 ("The Company's proposed DSM Tariffs (proposed to be effective on August 23, 2018) will terminate cost recovery of the monthly incentive payments through the DSM Surcharge, concurrent with the effective date of their inclusion in base rates, to ensure that there is no double recovery.").

DR incentive payments are included for recovery through MECO's base rates, they should not also be included as part of MECO's DSM Surcharge. Accordingly, the Parties' stipulated proposed revisions to MECO's DSM tariff are approved and shall take effect concurrent with the effective date of MECO's final rates.

The schedules of operations provided by the Parties, and approved by the commission, that were used to set MECO's interim rates include the costs associated with the Fast DR incentive payments, which were anticipated to coincide with revisions to MECO's DSM Tariff, under which cost recovery for the Fast DR Program incentives would shift from the DSM Surcharge to base rates.<sup>168</sup> However, as the commission did not rule on the proposed revisions to MECO's DSM tariff in Interim D&O 35631,<sup>169</sup> it is unclear whether MECO's Fast DR incentive payments have continued to be collected through the DSM Surcharge, notwithstanding their inclusion in interim rates.<sup>170</sup> To the extent cost recovery for MECO's Fast DR incentive payments have been included as part of MECO's interim rates and have also been collected through MECO's monthly DSM Surcharge, such duplicative cost recovery must be addressed. Pursuant to HRS § 269-16(d), MECO shall refund to its

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<sup>168</sup>See Settlement Agreement, Exhibit 1 at 65 (corrected June 21, 2018) and Demand Ratchet and DSM Tariffs.

<sup>169</sup>See Interim D&O 35631 52-54.

<sup>170</sup>See Demand Ratchet and DSM Tariffs at 1 n.4.

ratepayers any such costs that MECO has collected during this interim rate period, if any. If MECO has not collected any duplicative costs for the Fast DR incentive payments, MECO may clarify this, as discussed in Section II.D (HRS § 269-16(d) Statutory Refund Provision), below.

C.

Test Year Determinations

In the Settlement Agreement, the Parties reached an agreement on nearly all of MECO's 2018 Test Year rate case determinants, including revenue requirement and rate design. Accordingly, the commission turns to and expressly considers the Settlement Agreement (including the Parties' Joint Statement of Probable Entitlement) in determining the reasonableness of MECO's remaining 2018 Test Year revenue requirement determinants (subject to the commission's modifications discussed above) and rate design.

Pursuant to the Settlement Agreement and Joint Statement of Probable Entitlement, the Parties stipulated to the following revenue requirement components:<sup>171</sup>

Electric Sales Revenue	\$336,045,000
Other Operating Revenue	\$2,852,000
Gain on Sale of Land	<u>\$0</u>
TOTAL OPERATING REVENUES	\$338,897,000
Fuel	\$103,385,000
Purchased Power	\$54,970,000
Production	\$31,362,000
Transmission	\$3,928,000
Distribution	\$10,323,000
Customer Accounts	\$7,017,000
Allowance for Uncoll. Accounts	\$169,000
Customer Service	\$3,519,000
Administrative & General	\$21,332,000
Customer Benefit Adjustment	<u>(\$411,000)</u>
Total O&M Expenses	\$235,594,000
Depreciation & Amortization	\$29,591,000
Amortization of State Investment Tax Credit	(\$1,469,000)
Taxes Other Than Income	\$31,883,000
Interest on Customer Deposits	\$145,000
Income Taxes	<u>\$8,780,000</u>
Total Non-O&M Expenses	\$68,930,000
TOTAL OPERATING EXPENSES	\$304,524,000
OPERATING INCOME	\$34,373,000
AVERAGE RATE BASE	\$462,372,000
Rate of Return on Average Rate Base	7.43%

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<sup>171</sup>Joint Statement of Probable Entitlement, Attachment 2 at 1.

1.

Operating Revenues

The Parties have stipulated to 2018 Test Year operating revenues at proposed rates as follows:<sup>172</sup>

Electric Sales Revenue	\$336,045,000
Other Operating Revenues	\$2,852,000
Gain on Sale of Land	\$0
Total Operating Revenues	<u>\$338,897,000</u>

The Parties agree that MECO's total operating revenues at current effective rates are \$326,416,000.<sup>173</sup> In the Settlement Agreement, the Parties agree to total operating revenues of \$338,897,000 at proposed rates, which reflect an increase in total operating revenues of approximately \$12,481,000 compared to revenues at current effective rates.<sup>174</sup>

i.

Electric Sales Revenue

Electric sales revenue includes revenues from the base electric revenues as well as revenues from the ECAC and the Purchased Power Adjustment Clause ("PPAC").<sup>175</sup> To determine

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<sup>172</sup>Joint Statement of Probable Entitlement, Attachment 2 at 1.

<sup>173</sup>Joint Statement of Probable Entitlement, Attachment 2 at 1.

<sup>174</sup>Joint Statement of Probable Entitlement, Attachment 2 at 1.

<sup>175</sup>MECO Direct Testimony, MECO T-4 (Alvin J. Goto) at 5.

revenues at current effective rates, revenues from the RAM and RBA are included.<sup>176</sup>

The base electric charges for each rate class are comprised of: (1) the customer, demand, energy, and minimum charges; and (2) the power factor, service voltage, and other adjustments, as may be provided in each rate and rate rider schedule.<sup>177</sup>

The Parties have agreed to an average customer count of 71,676 and electric sales (MWh) of 1,073,201,<sup>178</sup> for a total electric sales revenue of \$323,658,000 at current effective rates for MECO's 2018 Test Year.<sup>179</sup> This amount represents a compromise between the Parties regarding MECO's 2018 Test Year residential sales, based on MECO's updated test year forecast for its Maui Division (reflecting higher sales),<sup>180</sup> as well as compromise on MECO's 2018 Test Year ECAC and PPAC revenues, based on a new production simulation performed by MECO (which incorporated many of the changes proposed by the Consumer Advocate in its

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<sup>176</sup>See MECO Direct Testimony, MECO T-4 (Alvin J. Goto) at 5.

<sup>177</sup>MECO Direct Testimony, MECO T-4 (Alvin J. Goto) at 5.

<sup>178</sup>Settlement Agreement, Exhibit 1 at 18.

<sup>179</sup>Settlement Agreement, Exhibit 1 at 21.

<sup>180</sup>Settlement Agreement, Exhibit 1 at 20-21.

Direct Testimony and resulted in lower ECAC and PPAC revenues).<sup>181</sup> The commission finds that the Parties' 2018 Test Year Electric Sales Revenue amount of \$323,658,000 at current effective rates is reasonable and reflects negotiated compromise of estimates soundly supported by the evidence presented.

Based on the above stipulated current effective rates, the Parties agree that a 2018 Test Year electric sales revenue of \$336,045,000 at proposed rates is necessary to produce the approved 7.43% rate of return on MECO's average rate base.<sup>182</sup> This represents an increase in electric sales revenue of approximately \$12,387,000 that MECO will need to collect in order to reach its 2018 Test Year revenue requirement.<sup>183</sup> The commission agrees with the Parties' calculations and finds the stipulated 2018 Test Year Electric Sales Revenue amount of \$336,045,000 at proposed rates reasonable.

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<sup>181</sup>Settlement Agreement, Exhibit 1 at 21-22.

<sup>182</sup>See Joint Statement of Probable Entitlement, Attachment 2 at 1.

<sup>183</sup>See Joint Statement of Probable Entitlement, Attachment 2 at 1.



Other Operating Revenue (Including Gain On Sale Of Land)

Other operating revenue for MECO's 2018 Test Year primarily consists of OCARS Late Payment Charges, other revenues, miscellaneous services revenues, rent from electric property, and other electric revenues.<sup>184</sup>

The Parties have stipulated to \$2,758,000 in Other Operating Revenue at current effective rates.<sup>185</sup> This amount apparently includes the Parties' agreement regarding MECO's proceeds from the Paia Land Sale.<sup>186</sup>

On December 7, 2017, in Docket No. 2017-0423, MECO filed an application requesting commission approval to sell a substation property in Paia, Maui for an estimated gain of \$2,873,837.<sup>187</sup> MECO maintained that the purchase price and certain calculations based on the purchase price were "confidential pricing information" that "need[ed] to remain confidential until the sale of the [Paia] Property [was] completed to ensure that no unfair

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<sup>184</sup>MECO Direct Testimony, MECO T-11 (Annabel R. Arase) at 58.

<sup>185</sup>Joint Statement of Probable Entitlement, Attachment 2 at 1.

<sup>186</sup>See Settlement Agreement, Exhibit 1 at 23-25.

<sup>187</sup>See In re Maui Electric Company, Ltd., Docket No. 2017-0423, "Application of Maui Electric Company, Limited; Verification; Exhibits 1-7; and Certificate of Service," filed December 7, 2017 ("Paia Land Sale Application"), at Exhibit 6 (Confidential Supplement filed January 23, 2018).

advantage [was] given to any potential future purchasers and to allow for the greatest return to customers."<sup>188</sup> Accordingly, in Docket No. 2017-0423, the commission issued a protective order to redact confidential information.<sup>189</sup>

On June 7, 2018, the commission issued Decision and Order No. 35519 in Docket No. 2017-0423 ("D&O 35519"), approving MECO's request for the Paia Land Sale.<sup>190</sup> In pertinent part, D&O 35519 instructed MECO to incorporate the impacts of the gain on the sale of the Paia property into MECO's 2018 Test Year for purposes of interim and final rate relief.<sup>191</sup> Furthermore, the commission instructed MECO to provide final reporting stating the final sale of the price received for the Paia Land Sale, the final cost to conclude and close the Paia Land Sale, and the final net gain from the Paia Land Sale.<sup>192</sup>

Regarding regulatory treatment of the gain from the Paia Land Sale, the Parties have agreed to adopt the Consumer Advocate's proposal to amortize the gain over three years, with the

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<sup>188</sup>Settlement Agreement, Exhibit 1 at 23-24.

<sup>189</sup>See In re Maui Electric Company, Ltd., Docket No. 2017-0423, Protective Order No. 35227, filed January 18, 2018.

<sup>190</sup>In re Maui Electric Company, Limited, Docket No. 2017-0150, Decision and Order No. 35519, filed June 7, 2018.

<sup>191</sup>D&O 35519 at 2, 23 and 30.

<sup>192</sup>D&O 35519 at 2.

unamortized balance incorporated as a reduction to MECO's 2018 Test Year rate base.<sup>193</sup>

At the time of the Parties' June 21, 2018 Settlement Agreement in this proceeding, the Paia Land Sale had not yet closed.<sup>194</sup> As a result, in the Settlement Agreement, the Parties appear to have utilized the estimated net gain for the Paia Land Sale based on the figures provided in MECO's application in Docket No. 2017-0423; i.e., \$2,874,000.<sup>195</sup> Applying the stipulated three-year amortization period resulted in: (1) an amortization amount of \$958,000; and (2) an estimated remaining unamortized balance of \$1,916,000.<sup>196</sup>

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<sup>193</sup>Settlement Agreement, Exhibit 1 at 25-26; see also, D&O 35519 at 21-22. MECO had initially proposed an amortization period of five years, but subsequently agreed to three years. Id.

<sup>194</sup>See In re Maui Electric Company, Limited, Docket No. 2017-0423, "Letter From: K. Katsura To: Commission Re: Docket No. 2017-0423; First Amendment to Purchase and Sale Agreement with Paia Bay Properties, LLC," filed June 27, 2018 (informing the commission that the parties to the Paia Land Sale had agreed to extend the closing date to occur on or before August 6, 2018).

<sup>195</sup>See Settlement Agreement, Exhibit 1 at 23-25 (citing MECO response to CA-IR-14, filed January 12, 2018); and MECO response to CA-IR-14 (August 13, 2018 Supplement). In its August 13, 2018 Supplement un-redacting the Paia Land Sale pricing information, MECO noted that "[t]he actual impact to 2018 test year revenue requirements will depend on the costs incurred to sell the Property, as this will offset against the proceeds from the sale." MECO response to CA-IR-14 at 2 n.1 (August 13, 2018 Supplement).

<sup>196</sup>See Settlement Agreement, MECO T-12, Attachment 7 at 1; and MECO response to CA-IR-14 (August 13, 2018 Supplement), Attachment 1 at 4 (MECO's August 13, 2018 Supplement presumed a five-year amortization period, as originally proposed by MECO,

As a result of the (then) unresolved nature of the Paia Land Sale, in order to preserve the confidentiality of the sale amount, the Parties agreed to incorporate the Paia Land Sale into MECO's 2018 Test Year revenue requirement in a way that would not prematurely disclose the actual sale amount in the Settlement Agreement.<sup>197</sup> Specifically, the Parties agreed to the following ratemaking treatment for the gains from the Paia Land Sale: (1) MECO included the amortization amount in Other Operating Revenues (versus "Gain on Sale of Land"), which decreased the revenue increase for the 2018 Test Year without disclosing the sale amount;<sup>198</sup> and (2) MECO included the unamortized average gain on sale balance as a deduction to "Other Deferred Costs"

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and not the three-year amortization period ultimately agreed to by the Parties).

<sup>197</sup>The Paia Land Sale ultimately closed on August 9, 2018, and the sale price and related figures have since then been publicly disclosed. See In re Maui Electric Company, Limited, Docket No. 2017-0423, Letter From: K. Katsura To: Commission Re: Docket No. 2017-0423 - For Approval to Sell a Utility Substation Property in Paia, Maui; Final Accounting of the Sale Report," filed December 4, 2018 ("Paia Land Sale Final Report").

<sup>198</sup>See Settlement Agreement, MECO T-4, Attachment 1 (August 13, 2018 Supplement) at 2; see also, id., Exhibit 1 at 25. In particular, the amortization is included as an increase to MECO's Maui Division's Other Operating Revenue at current effective rates. See Settlement Agreement, MECO T-4, Attachment 1 at 2 (reflecting consolidated total operating revenues at current effective rates of \$326,416,100, which includes "\$958,000 for the Amortization of the Gain on Sale of the Paia Property"); and Joint Statement of Probable Entitlement, Attachment 2 at 1 (reflecting consolidated total revenues at current effective rates of \$326,416,000)

(versus "Unamortized Gain on Sales of Land"), which decreased MECO's test year rate base without disclosing the sale amount.<sup>199</sup> These adjustments were approved as part of Interim D&O 35361 and are reflected in MECO's interim rates.<sup>200</sup>

In addition, the Parties stipulate to \$94,000 in additional revenues to Other Operating Revenues. According to the Settlement Agreement, this reflects "additional revenues due to the Company's proposed rule changes, to which the Parties agree in the rate design section."<sup>201</sup> This arises from MECO's proposed modifications to its tariff rules, including Tariff Rule No. 3 (removing a \$10 payment for afterhours connections), Tariff Rule No. 7 (increasing from \$20 to \$25 the service charge for connecting or reconnecting service outside of regular business hours or for same day service), and Tariff Rule No. 8 (re-naming the "Returned

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<sup>199</sup>See Settlement Agreement, MECO T-12, Attachment 7 (August 13, 2018 Supplement) at 1.

<sup>200</sup>See Settlement Agreement, Exhibit 1 at 25 and 109.

On December 4, 2018, in Docket No. 2017-0423, MECO provided a Final Accounting of the Paia Land Sale in which it disclosed that the actual net proceeds are \$2,905,973. Paia Land Sale Final Report, Exhibit 1 at 1. In its Final Accounting for the Paia Land Sale, MECO states that it has recorded the actual \$2,905,973 to a deferred liability account, which it will amortize over thirty-six months, beginning August 23, 2018." Id. at 1 n.1. Thus, MECO has accounted for the slight increase to the gain on sale of land resulting from the actual sale price for the Paia Land Sale and incorporated the actual gain into a deferred liability account to be returned to ratepayers.

<sup>201</sup>Settlement Agreement, Exhibit 1 at 23.

Check Charge" to "Returned Payment Charge" and decreasing from \$25 to \$20 the field collection charge),<sup>202</sup> which the Consumer Advocate does not oppose.<sup>203</sup>

These stipulations result in \$2,852,000 in Other Operating Revenue at proposed rates. The commission finds that the Parties' 2018 Test Year Other Operating Revenue amount of \$2,758,000 at current effective rates and \$2,852,000 at proposed rates is reasonable and reflects a negotiated compromise. However, regarding the accounting treatment and recording of the gains from the Paia Land Sale, the commission notes that these figures were obscured during this proceeding. It appears that this was done to preserve the confidentiality of the sale amount until the transaction was officially closed. Now that the sale has been consummated, MECO should categorize the treatment of the Paia Land Sale in more express terms, such that tracking the regulatory treatment of the net gains on the sale can be accomplished with greater transparency. As discussed above, MECO shall collaborate with the Consumer Advocate to develop and submit revised schedules of operations within thirty days of this Decision and Order that reflect the commission's rulings regarding the Substation Projects

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<sup>202</sup>See MECO Direct Testimony, MECO T-11 (Annabel R. Arase) at 59-61.

<sup>203</sup>See CA Direct Testimony, CA-T-2 (Michael L. Brosch) at 133-34.

costs and the deferred O&M expenses for the Ma`alaea Project. In their submission, the Parties shall also reflect the gain on the Paia Land Sale correctly in the appropriate categories and schedules. Additionally, in MECO's next rate case, the regulatory treatment of the Paia Land Sale should be clearly and conspicuously identified in MECO's schedule of operations.

iii.

#### Summary

Based on the above, the commission approves as reasonable total operating revenues for MECO's 2018 Test Year of \$326,416,000 at current effective rates and \$338,897,000 at proposed rates, subject to any necessary adjustments resulting from the commission's modifications discussed herein.

2.

#### Operations And Maintenance Expenses

As a result of the Settlement Agreement, the Parties have stipulated to the following 2018 Test Year O&M expenses:<sup>204</sup>

Fuel	\$103,385,000
Purchased Power	\$54,970,000
Production	\$31,362,000
Transmission	\$3,928,000

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<sup>204</sup>Joint Statement of Probable Entitlement, Attachment 2 at 1. See also, Settlement Agreement, Exhibit 1 at 29 (corrected June 21, 2018).

Distribution	\$10,323,000
Customer Accounts	\$7,017,000
Allowance for Uncoll. Accounts	\$169,000
Customer Service	\$3,519,000
Administrative and General ("A&G")	\$21,332,000
Customer Benefit Adjustment	<u>(\$411,000)</u>
Total O&M Expenses	\$235,594,000

i.

Non-Specific O&M Account Adjustments

In reaching these stipulated amounts, the Parties have agreed to a number of adjustments to cost factors that apply broadly across a number of O&M accounts. As these adjustments do not apply specifically to the particular NARUC accounts listed above, the commission will discuss them here.

The Parties have agreed to a downward adjustment to MECO's 2018 Test Year O&M to reflect the Parties' agreement on MECO's employee vacancy rate, which reduces O&M labor costs and associated employee benefits and payroll taxes expenses. In its Direct Testimony, MECO assumed an employee vacancy rate of 2.78%, based on the actual/budgeted employee variances from January 2012 to March 2017.<sup>205</sup> The Consumer Advocate maintained that the employee vacancy rate should be based on more recent historical data, and proposed a 3.36% employee vacancy rate based on data

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<sup>205</sup>Settlement Agreement, Exhibit 1 at 36.



from the two-year period ending December 2017.<sup>206</sup> In the Settlement Agreement, the Parties have agreed to the Consumer Advocate's recommended employee vacancy rate of 3.36%, which downwardly adjusts MECO's 2018 Test Year O&M by \$178,000 (\$121,000 in labor expenses, \$48,000 in employee benefits, and \$9,000 in payroll taxes).<sup>207</sup>

The Parties have also agreed to a downward adjustment to account for the impacts of the interim decision and order in HECO's rate case, Docket No. 2016-0328, on the intercompany billing ("ICB") overhead loading estimates from HECO to MECO.<sup>208</sup> Specifically, MECO maintained that the rulings in Interim D&O 35100 impacted the amount of pension and other post-employment benefits ("OPEB") costs subject to the employee benefits transfer rate and, ultimately, the employee benefits loading included in the ICB estimates.<sup>209</sup> MECO used the adjustments in the HECO rate case to create a proxy analysis of similar adjustments for MECO, resulting in a downward adjustment to O&M expenses of \$414,000.<sup>210</sup>

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<sup>206</sup>See Settlement Agreement, Exhibit 1 at 36.

<sup>207</sup>Settlement Agreement, Exhibit 1 at 36.

<sup>208</sup>See Settlement Agreement, Exhibit 1 at 36 (referencing Interim Decision and Order No. 35100, filed December 15, 2017, in Docket No. 2016-0328 ("Interim D&O 35100")).

<sup>209</sup>Settlement Agreement, Exhibit 1 at 36.

<sup>210</sup>See Settlement Agreement, Exhibit 1 at 36-37. Specifically, the ICB adjustment resulted in downward adjustments to MECO's Production, Transmission, Distribution,

In the Settlement Agreement, the Parties agreed to incorporate the entire ICB overhead loadings adjustment amount of \$414,000 into MECO's 2018 Test Year O&M expenses.<sup>211</sup>

In its Direct Testimony, the Consumer Advocate also proposed a vacancy rate adjustment to labor and on-costs billed from HECO to MECO through the ICB process.<sup>212</sup> The Consumer Advocate arrived at this adjustment by applying the HECO 2017 test year rate case (Docket No. 2016-0328) vacancy rate of 5.36% to labor and on-costs billed to MECO, resulting in a proposed downward adjustment of \$224,000 to MECO's 2018 Test Year expenses.<sup>213</sup> In response, MECO maintained that a "universal" vacancy adjustment rate may not be appropriate, as some vacancies arise in areas that are sensitive and must be filled immediately through paying overtime or retaining contractors, consultants, or temporary hires, but agreed that it may be applicable to "areas that employ the shared services model where the costs for a function are allocated/shared among the three [HECO] [C]ompanies[.]"<sup>214</sup> In the

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Customer Accounts, Customer Service, and A&G accounts. See id. at 37, Table 12.

<sup>211</sup>Settlement Agreement, Exhibit 1 at 37.

<sup>212</sup>Settlement Agreement, Exhibit 1 at 37.

<sup>213</sup>Settlement Agreement, Exhibit 1 at 37.

<sup>214</sup>Settlement Agreement, Exhibit 1 at 37-38; see also, MECO response to CA-IR-348, filed March 27, 2018.

Settlement Agreement, the Parties agreed to a vacancy rate adjustment for HECO ICBs to MECO that largely adopts the Consumer Advocate's proposal, but removes some of the ICB areas for which MECO maintains a vacancy adjustment is not appropriate. As a result, the Parties have stipulated to a downward adjustment of \$193,210 to MECO's 2018 Test Year O&M expenses.<sup>215</sup>

The Parties have also agreed to a downward adjustment to MECO's 2018 Test Year related to meals, entertainment, and travel expenses ("Meals, Entertainment, and Travel").<sup>216</sup> Initially, the Consumer Advocate proposed downward adjustments to MECO's test year estimates based on historical data from the years 2015-2017.<sup>217</sup> In response, MECO maintained that it has already taken efforts following its last general rate case (Docket No. 2011-0092) to manage its expenses, and that "[t]ravel, meals and entertainment expenses between 2013 and 2017 have been suppressed to an unsustainable level to be able to support the Company's success."<sup>218</sup> According to MECO, "[i]f the 2018 test year estimates are based on such historical data, the rate relief for this triennial cycle

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<sup>215</sup>Settlement Agreement, Exhibit 1 at 38. In particular, downward adjustments were made to MECO's Production, Customer Accounts, Customer Services, and A&G accounts.

<sup>216</sup>Settlement Agreement, Exhibit 1 at 39.

<sup>217</sup>See Settlement Agreement, Exhibit 1 at 38.

<sup>218</sup>Settlement Agreement, Exhibit 1 at 39.

would not allow for employees to provide the technical support needed for the Company to tackle the challenges it faces in an efficient and innovative fashion."<sup>219</sup> Ultimately, in the Settlement Agreement, the Parties agreed to reduce MECO's O&M expenses by \$60,000, which is less than the Consumer Advocate's initial proposed downward adjustment of \$98,000.<sup>220</sup>

ii.

Fuel

MECO uses a combination of industrial fuel oil ("IFO"), ultra-low sulfur diesel ("ULSD"), diesel, and biodiesel for its Maui Division and ULSD for its Lanai and Molokai Divisions.<sup>221</sup> MECO's fuel expense is composed of: (1) fuel oil expenses; and (2) fuel-related expenses.<sup>222</sup> MECO's fuel oil expense is determined by multiplying fuel price by fuel consumption.<sup>223</sup> MECO's fuel-related expenses include ignition start-up and fuel

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<sup>219</sup>Settlement Agreement, Exhibit 1 at 39.

<sup>220</sup>Settlement Agreement, Exhibit 1 at 38-40. In particular, downward adjustments were made to MECO's Production, Transmission, Distribution, Customer Services, and A&G accounts. Id. at 40.

<sup>221</sup>MECO Direct Testimony, MECO T-6 (Nicolas O. Paslay) at 3.

<sup>222</sup>MECO Direct Testimony, MECO T-6 (Nicolas O. Paslay) at 1.

<sup>223</sup>MECO Direct Testimony, MECO T-6 (Nicolas O. Paslay) at 1.

handling, fuel inspections, fuel combustion additive, and ocean cargo insurance.<sup>224</sup>

In the Settlement Agreement, the Parties stipulated to a 2018 Test Year fuel expense of \$103,385,000, which is comprised of \$94,000,000 for Maui Division (reflecting \$93,693,000 in fuel oil expenses and \$307,000 in fuel-related expense), \$4,933,000 for Lanai Division (reflecting \$4,933,000 in fuel oil expense and \$0 in fuel-related expenses), and \$4,452,000 for Molokai Division (reflecting \$4,431,000 in fuel oil expense and \$21,000 in fuel-related expense).<sup>225</sup> These stipulated amounts reflect adjustments based on: (1) the results of MECO's updated production simulation for its Maui Division; and (2) updating Lanai Division's and Molokai Division's respective average net heat rates to reflect their 2013-2017 actual average net heat rates.<sup>226</sup>

Based on the commission's review of the record, the commission finds reasonable the Parties' 2018 Test Year stipulated fuel expense of \$103,385,000.

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<sup>224</sup>MECO Direct Testimony, MECO T-6 (Nicolas O. Paslay) at 1.

<sup>225</sup>Settlement Agreement, Exhibit 1 at 29-30 and 33. See also, Joint Statement of Probable Entitlement, Attachment 2 at 1.

<sup>226</sup>See Settlement Agreement, Exhibit 1 at 33.

Purchased Power

In addition to its own generation facilities, MECO also purchases power from a number of renewable energy independent power producers ("IPPs") through Power Purchase Agreements ("PPAs"). Specifically, the Maui Division purchases energy from Kaheawa Wind Power, LLC, Kaheawa Wind Power II, LLC, Auwahi Wind Energy, and Makila Hydro, LLC, as well as solar energy from a number of Feed-in-Tariff projects.<sup>227</sup> MECO also has commission-approved PPAs with Ku`ia Solar LLC facility and South Maui Renewable Resources LLC facility and anticipated that both would begin commercial operation in the Maui Division by the end of 2017 and included both in its 2018 Test Year.<sup>228</sup> The Lanai Division purchases energy from the Lanai Sustainability Research facility.<sup>229</sup> The Molokai Division does not have any applicable PPAs, but receives energy pursuant to its Feed-in-Tariff contract.<sup>230</sup>

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<sup>227</sup>MECO Direct Testimony, MECO T-5 (Robert Y. Uyeunten) at 3-4.

<sup>228</sup>MECO Direct Testimony, MECO T-5 (Robert Y. Uyeunten) at 5. Commission approval of the PPAs with Ku`ia Solar LLC and South Maui Renewable Resources LLC were the subjects of Docket Nos. 2015-0224 and 2015-0225, respectively.

<sup>229</sup>MECO Direct Testimony, MECO T-5 (Robert Y. Uyeunten) at 6.

<sup>230</sup>See MECO Direct Testimony, MECO-708 at 1 and MECO-708A at 4.

Initially, the Consumer Advocate proposed an alternative purchased power expense for MECO's Maui Division based on the Consumer Advocate's exclusion of the Ku'ia Solar LLC and South Maui Renewable Resources LLC facilities for a portion of the 2018 Test Year.<sup>231</sup> However, as noted above, MECO subsequently performed an updated production simulation for the 2018 Test Year, which resulted in an updated purchased power expense of \$54,970,000, consisting of \$54,378,000 for Maui Division, \$590,000 for Lanai Division, and \$1,000 for Molokai Division.<sup>232</sup> The Parties have stipulated to this amount.<sup>233</sup>

Based on the commission's review of the record, the commission finds reasonable the Parties' 2018 Test Year stipulated purchased power expense of \$54,970,000.

iv.

Production

MECO's production O&M expense consists of the cost of labor, materials, outside services, and associated overheads required to operate and maintain MECO's generation fleet for its

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<sup>231</sup>See CA Direct Testimony, CA-T-3 (Trey A. Shepherd) at 27.

<sup>232</sup>Settlement Agreement, Exhibit 1 at 35.

<sup>233</sup>Settlement Agreement, Exhibit 1 at 29 and 35; and Joint Statement of Probable Entitlement, Attachment 2 at 1. The commission observes that the stipulated amounts sum to \$54,969,000, but attributes the \$1,000 discrepancy to rounding.

three island divisions, and include overhauling the generating units, operating the units, and performing corrective maintenance, structural maintenance, and environmental compliance.<sup>234</sup> MECO's Maui Division has 27 generating units that it plans to operate during this rate case cycle, including 21 units at the Ma'alaea Power Plant, 4 units at the Kahului Power Plant, and 2 units at the Hana Substation.<sup>235</sup> Lanai Division has 8 generating units at the Miki Basin Power Plant and an additional unit adjacent to the Manele Bay Hotel.<sup>236</sup> Molokai Division has 10 units at the Palaaau Power Plant.<sup>237</sup>

In the Settlement Agreement, the Parties agreed to downwardly adjust a number of MECO's production sub-components.<sup>238</sup> First, as discussed above, several adjustments related to specific expenses were allocated among NARUC block accounts, including the Production account (i.e., adjustments for employee vacancy, HECO ICB overhead loadings, and meals, travel, and entertainment),

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<sup>234</sup>MECO Direct Testimony, MECO T-8 (Matthew M. McNeff) at 33.

<sup>235</sup>MECO Direct Testimony, MECO T-8 (Matthew M. McNeff) at 5-6 and MECO-808 at 1.

<sup>236</sup>MECO Direct Testimony, MECO T-8 (Matthew M. McNeff) at 8 and MECO-808 at 2.

<sup>237</sup>MECO Direct Testimony, MECO T-8 (Matthew M. McNeff) at 9 and MECO-808 at 3.

<sup>238</sup>See Settlement Agreement, Exhibit 1 at 40, column E; see also, id. at 29 (corrected June 21, 2018).



resulting in a decrease of \$116,000.<sup>239</sup> Second, the Parties agreed to use the Consumer Advocate's methodology to reduce overtime calculations, resulting in a decrease of \$525,000 in labor expenses.<sup>240</sup> The Parties also agreed to fifteen non-labor O&M adjustments, resulting in a decrease of \$2,080,000.<sup>241</sup>

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<sup>239</sup>See Section II.C.2.i (Non-Specific O&M Account Adjustments), above; and Settlement Agreement, Exhibit 1 at 40.

<sup>240</sup>See Settlement Agreement, Exhibit 1 at 40-42. The Consumer Advocate's overtime calculations also resulted in a downward adjustment of \$44,000 in associated payroll taxes. Id. at 42 and 84.

<sup>241</sup>See Settlement Agreement, Exhibit 1 at 40 and 44-45. Specifically, the Consumer Advocate proposed fifteen non-labor O&M adjustments to MECO's Production expenses. Of these, MECO did not dispute items (2) through (9), agreeing that they pertained to corrections and updates to previously filed estimates. Id. at 44.

Regarding item (11), MECO accepted this adjustment, but maintained that it should be re-classified as an adjustment to MECO's Customer Service account, to which the Consumer Advocate agreed. Id. at 44-45.

Likewise, MECO did not dispute item (12), regarding the removal of amortization expenses for the Ma'alaea Project. Id. at 51. As discussed above and in Interim D&O 35631, the issue of cost recovery for the Ma'alaea Project's O&M expenses has been resolved by D&O 36159. See Section II.B.4 (Cost Recovery Issues Related To Docket No. 2016-0345), above; and Interim D&O 35631 at 49-52.

MECO also accepted item (13), regarding test year expense estimates that may be affected by the outcome of MECO's arbitration over the Kahului Harbor rent expense to the State Department of Transportation Harbors Division. Id. at 52-53.

Regarding items (1), (10), and (14), the Parties reached agreement, but decreased the amount of downward adjustment initially proposed by the Consumer Advocate. See id. at 45-49 and 53-54.

As a result, the Parties have stipulated to a downward adjustment of \$2,720,000 to Production expenses, resulting in a 2018 Test Year Production expense of \$31,362,000.<sup>242</sup>

Based on the commission's review of the record, the commission finds reasonable the Parties' 2018 Test Year production expense amount of \$31,362,000.

v.

Transmission And Distribution

MECO's transmission and distribution system interconnects and delivers electricity from traditional generating facilities (which MECO owns and operates), IPPs, dispersed and customer-owned renewable energy generation facilities, and MECO's residential, commercial, and industrial customers.<sup>243</sup>

MECO initially proposed 2018 Test Year Transmission O&M expenses of \$3,936,000 and 2018 Test Year Distribution O&M expenses of \$10,394,000.<sup>244</sup> In the Settlement Agreement, the Parties

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Lastly, regarding item (15), the Parties agreed to accept the Consumer Advocate's proposed upward adjustment of \$4,000 to normalize the biofuel testing expense. Id. at 49.

<sup>242</sup>See Settlement Agreement, Exhibit 1 at 29 and 40; and Joint Statement of Probable Entitlement, Attachment 2 at 1.

<sup>243</sup>See MECO Direct Testimony, MECO T-10 (Gary A. Nieborsky), Summary at 1.

<sup>244</sup>See MECO Direct Testimony, MECO T-10 (Gary A. Nieborsky) at 2; see also, id. MECO-1003 at 2 and 6 and MECO-2509 at 1.

stipulated to downward adjustments of \$8,000 in transmission expenses and \$70,000 in distribution expenses, resulting in proposed 2018 Test Year transmission and distribution expenses of \$3,928,000 and \$10,323,000, respectively.<sup>245</sup>

These stipulated amounts reflect the Parties' agreements discussed above regarding a number of downward adjustments related to specific expenses (e.g., Customer Service Labor adjustment,<sup>246</sup> Employee Vacancy, HECO ICB Overhead Loading, and Meals, Entertainment, and Travel) that were allocated among MECO's NARUC block accounts, including Transmission and Distribution,<sup>247</sup> resulting in stipulated 2018 Test Year expenses of \$3,928,000 for Transmission and \$10,323,000 for distribution.<sup>248</sup>

Based on the commission's review of the record, the commission finds reasonable the Parties' 2018 Test Year

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<sup>245</sup>Settlement Agreement, Exhibit 1 at 29 and 55.

<sup>246</sup>MECO's Customer Service Labor adjustment is discussed in Section II.C.2.vi (Customer Accounts), below. Similar to the other O&M expense adjustments discussed in Section II.C.2.i (Non-Specific O&M Account Adjustments), the Customer Service Labor adjustment is dispersed among several O&M NARUC block accounts, including Distribution, Customer Accounts, and Customer Service. See Settlement Agreement, Exhibit 1 at 57.

<sup>247</sup>See Section II.C.2.i (Non-Specific O&M Account Adjustments), above.

<sup>248</sup>See Settlement Agreement, Exhibit 1 at 29; and Joint Statement of Probable Entitlement, Attachment 2 at 1.

transmission and distribution expense amounts of \$3,928,000 and \$10,323,000, respectively.

vi.

#### Customer Accounts

MECO's customer accounts expense:

[I]ncludes the costs incurred for activities the Company provides to serve its customers that relate to: customer billing (including the cost of processing customer requests to commence, modify or terminate service) and mailing; meter reading; collecting and processing payments; handling customer inquiries; maintaining customer records; managing delinquent and uncollectible accounts; and conducting field services and investigations.<sup>249</sup>

This also includes a component for uncollectible accounts.<sup>250</sup> However, for purposes of approving MECO's 2018 Test Year schedules of operations, MECO's Uncollectible Accounts expense is reflected as a separate line item from Customer Accounts.

In its Direct Testimony, MECO proposed a 2018 Test Year Customer Accounts expense of \$7,351,000, which included an

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<sup>249</sup>MECO Direct Testimony, MECO T-11 (Anabel R. Arase) at 55.

<sup>250</sup>See MECO Direct Testimony, MECO T-11 (Anabel R. Arase) at 55 (regarding Account 904, "Losses from uncollectible utility revenues").

estimated \$233,000 in Uncollectible Accounts.<sup>251</sup> Subsequently, as discussed above, the Parties reached an agreement on a number of specific expenses (e.g., Employee Vacancy, HECO ICB Overhead Loading, and HECO ICB Employment Vacancy) which resulted in downward adjustments to a number of MECO's NARUC block accounts, including a downward adjustment of \$92,000 to Customer Accounts.<sup>252</sup>

In addition, the Parties agreed to several additional adjustments to MECO's Customer Accounts expense, including a Customer Service Labor adjustment, a Customer Service Department adjustment (comprised of several line item adjustments to the NARUC block Customer Service account), and an Uncollectible Accounts Normalization adjustment.

The Customer Service Labor adjustment reflects the Parties' agreement on the vacancy rate to be applied to certain billed labor costs charged to MECO's Customer Service Department.<sup>253</sup> In its Direct Testimony, MECO proposed a vacancy rate of 3.71% based on the sixty-month period between April 2012 and March 2017.<sup>254</sup> In response, the Consumer Advocate recommended

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<sup>251</sup>Settlement Agreement, Exhibit 1 at 56 (citing MECO Direct Testimony, MECO-1103).

<sup>252</sup>See Section II.C.2.i (Non-Specific O&M Account Adjustments), above; see also, Settlement Agreement, Exhibit 1 at 56.

<sup>253</sup>Settlement Agreement, Exhibit 1 at 56.

<sup>254</sup>Settlement Agreement, Exhibit 1 at 56.

using an updated vacancy rate of 4.27%, based on data from calendar years 2016 and 2017, which "is indicated to be more representative of ongoing business operations by excluding periods prior to 2015 when the Customer Service organization was not yet centralized within Hawaiian Electric and excluding periods of disruption in operations after completion of the Companies' new Customer Information System."<sup>255</sup> As a result, the Parties have agreed to a downward Customer Service Vacancy adjustment of \$21,000.<sup>256</sup> The Parties have further agreed that this adjustment should be allocated among several NARUC block accounts, including Distribution,<sup>257</sup> Customer Accounts, and Customer Service.<sup>258</sup> Regarding MECO's Customer Accounts, the Customer Service Vacancy adjustment reduces this expense by \$14,000.<sup>259</sup>

Conversely, the Customer Service Department adjustment reflects an upward adjustment to MECO's Customer Account based on a number of non-labor expense adjustments to MECO's Customer Service Department that are spread across MECO's Customer Accounts, Customer Service, and A&G NARUC block accounts

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<sup>255</sup>Settlement Agreement, Exhibit 1 at 57.

<sup>256</sup>Settlement Agreement, Exhibit 1 at 57.

<sup>257</sup>See n.246, supra.

<sup>258</sup>See Settlement Agreement, Exhibit 1 at 57.

<sup>259</sup>Settlement Agreement, Exhibit 1 at 57.

(the Customer Service Department adjustment is discussed in each of these sections, as applicable).<sup>260</sup> In particular, the Parties agreed that three of these expense adjustments should apply to MECO's Customer Accounts: GEMS On-bill Program costs, revised payment kiosk expense estimate, and digital signage revised expense estimate.<sup>261</sup> As a result, the Parties agreed to an upward adjustment of \$5,000 to MECO's Customer Accounts.<sup>262</sup>

In sum, the Parties have agreed to adjustments to MECO's Customer Accounts 2018 Test Year O&M expenses that result in a total downward adjustment of \$101,000.<sup>263</sup> Accordingly, the Parties have stipulated to a 2018 Test Year Customer Accounts O&M expense of \$7,017,000, excluding Uncollectible Accounts.<sup>264</sup>

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<sup>260</sup>See Settlement Agreement, Exhibit 1 at 58. The specific expenses apply to: Finance & Business Planning expenses; GEMS On-bill Program consulting, revised payment kiosk expense estimate, digital signage revised expense estimate, revised allocation of DER leadership costs, forward looking study cost normalization, and costs related to MECO's Marketing department. Id.

<sup>261</sup>Settlement Agreement, Exhibit 1 at 58.

<sup>262</sup>Settlement Agreement, Exhibit 1 at 56 and 58. The Parties agreed to downward adjustments for the revised payment kiosk expense estimate and the digital signage revised expense estimate, but these downward adjustments were dwarfed by the stipulated upward adjustment for the GEMS On-bill Program consulting expenses, resulting in a net upward adjustment of \$5,000. See id.

<sup>263</sup>Settlement Agreement, Exhibit 1 at 29 and 56.

<sup>264</sup>See Settlement Agreement, Exhibit 1 at 29; and Joint Statement of Probable Entitlement, Attachment 2 at 1. 7,351,000 [initial proposed amount] - 233,000 [initial proposed

The Parties also agreed to an adjustment to MECO's Uncollectible Accounts to reflect updated data. In its Direct Testimony, MECO proposed an Uncollectible Accounts expense of \$233,000 based on a three-year average of Adjusted Net Write-Offs for the years 2014-2016.<sup>265</sup> In response, the Consumer Advocate proposed updating this adjustment based on more recent data from the 2017 calendar year, "when collection experience was much improved over the older 2014 data," resulting in a proposed a downward adjustment of \$64,000 to MECO's Uncollectible Accounts, to which the Parties have agreed.<sup>266</sup> Accordingly, the Parties have stipulated to an Uncollectible Accounts expense of \$169,000 for the 2018 Test Year.<sup>267</sup> (The Consumer Advocate's analysis of MECO's Uncollectible Accounts included a \$7,000 downward adjustment for uncollectible amounts of other customer accounts receivable; however, as this was included in the test year estimate for Account No. 924, property insurance

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Uncollectible Accounts] - 101,000 [stipulated adjustments] = 7,017,000.

<sup>265</sup>Settlement Agreement, Exhibit 1 at 57.

<sup>266</sup>Settlement Agreement, Exhibit 1 at 29 and 57-58.

<sup>267</sup>See Settlement Agreement, Exhibit 1 at 29; and Joint Statement of Probable Entitlement, Attachment 2 at 1. 233,000 [initial proposed amount] - 64,000 [stipulated adjustments] = 169,000.



of A&G O&M expense, in MECO's Direct Testimony, the Parties agreed that this should be addressed as part of MECO's A&G expenses).<sup>268</sup>

Based on the commission's review of the record, the commission finds reasonable the Parties' 2018 Test Year Customer Accounts and Uncollectible Accounts expense amounts of \$7,017,000 and \$169,000, respectively.

vii.

#### Customer Service

According to its Direct Testimony, MECO's Customer Service expenses include: "[g]eneral direction and supervision of customer service activities . . . . [p]roviding instructions or assistance to present customers . . . . [a]dvertising activities which primarily convey concrete information as to what the utility urges or suggests customers should do in using electric service [to protect health and safety, promote environmental protection, conserve electric energy, and support achievement of Hawaii's clean energy goals] . . . . [and] [m]iscellaneous customer service activities which are not includable in other customer service expense accounts."<sup>269</sup>

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<sup>268</sup>See Settlement Agreement, Exhibit 1 at 58 and 66 (corrected June 21, 2018). See also, Section II.C.2.viii (A&G), below.

<sup>269</sup>MECO Direct Testimony, MECO T-7 (Ellen S. Nashiwa) at 8-9.

In its Direct Testimony, MECO proposed 2018 Test Year Customer Service O&M expenses of \$6,378,000.<sup>270</sup> As discussed above, the Parties have agreed to downward adjustments related to Employee Vacancy, HECO's ICB Overhead Loading, and HECO's ICB Employee Vacancy which have been apportioned, in part, to MECO's Customer Service expenses, resulting in downward adjustments to MECO's Customer Service expenses of \$3,000, \$46,000, and \$32,000, respectively.<sup>271</sup>

Similarly, as also discussed above, the Parties have agreed to a Customer Service Labor adjustment and a Customer Service Department adjustment, with the Customer Service Labor adjustment downwardly adjusting MECO's Customer Service expenses by \$2,000, but with the Customer Service Department adjustment increasing MECO's Customer Service expenses by \$140,000.<sup>272</sup> As noted above, the Customer Service Labor adjustment arises from the application of updated data to determine the vacancy rate adjustment for certain billed charged to MECO's Customer Service Department.<sup>273</sup>

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<sup>270</sup>Settlement Agreement, Exhibit 1 at 59 (citing MECO Direct Testimony, MECO T-7 (Ellen S. Nashiwa) at 8-10)).

<sup>271</sup>See Settlement Agreement, Exhibit 1 at 59; and Section II.C.2.i (Non-Specific O&M Account Adjustments), above.

<sup>272</sup>See Settlement Agreement, Exhibit 1 at 58-59.

<sup>273</sup>See Settlement Agreement, Exhibit 1 at 56.

The Customer Service Department adjustment arises from the creation of the Hawaiian Electric Marketing Department, which "was formed in conjunction with the reorganization announced in January 2017 on the Customer Service Process Area . . . [and is expected to] benefit ratepayers by focusing on efforts that will allow customers to be better informed of programs that will enable them to manage their energy use, lower costs, support the grid, and help the State achieve its 100% renewable energy goals."<sup>274</sup> As noted above, the Customer Service Department adjustment has resulted in adjustments to several of MECO's 2018 Test Year NARUC block accounts, including Customer Accounts, Customer Service, and A&G.

As it pertains to the Customer Service account, MECO did not initially include any expenses for the new marketing department in MECO's Direct Testimony, but subsequently included a 2018 Test Year estimate of \$280,000 for MECO's "allocable share of Hawaiian Electric's Marketing Department billable costs" in its response to the Consumer Advocate's IRs."<sup>275</sup> The Consumer Advocate initially opposed inclusion of the \$280,000 in new Marketing Department costs, contending that the expenses "had not

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<sup>274</sup>Settlement Agreement, Exhibit 1 at 60.

<sup>275</sup>Settlement Agreement, Exhibit 1 at 60 (citing MECO response to CA-IR-347, filed April 2, 2018).

been defined in sufficient detail to evaluate whether they are cost effective and responsive to customers' needs," as well as other concerns related to the potential benefits that may accrue exclusively to MECO, at ratepayers' expense (e.g. "goodwill," expanded marketing, and market research).<sup>276</sup> MECO responded with additional testimony addressing the Consumer Advocate's concerns,<sup>277</sup> and the Parties ultimately stipulated to include half of MECO's estimated Marketing Department expenses into MECO's 2018 Test Year Customer Service O&M expenses; i.e., \$140,000.<sup>278</sup> Accordingly, the Parties have stipulated to an upward Customer Service Department adjustment of \$140,000 to MECO's Customer Service O&M expenses.

In addition, the Parties stipulated to two specific downward adjustments to MECO's Customer Service expenses related to MECO's PSIP consulting costs and MECO's DR program. Regarding MECO's PSIP consulting costs, MECO initially included \$263,000 in Customer Service expenses for the amortization of PSIP outside services deferred costs.<sup>279</sup> Subsequently, in HECO's 2017 test year rate case, Docket No. 2016-0328, the Parties agreed to remove

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<sup>276</sup>Settlement Agreement, Exhibit 1 at 60-61.

<sup>277</sup>See Settlement Agreement, MECO T-11, Attachment 1.

<sup>278</sup>See Settlement Agreement, Exhibit 1 at 62.

<sup>279</sup>Settlement Agreement, Exhibit 1 at 59.

HECO's PSIP non-labor consultant outside service costs from HECO's 2017 test year.<sup>280</sup> Likewise, the HECO Companies withdrew their application to defer recovery of their PSIP non-labor consultant outside services costs in Docket No. 2016-0156, citing HECO and the Consumer Advocate's November 2017 settlement agreement in Docket No. 2016-0328.<sup>281</sup> Based on the events in Docket Nos. 2016-0328 and 2016-0156, the Parties here agreed to a downward adjustment to MECO's Customer Service O&M expense to remove the \$263,000 of amortization expense related to MECO's PSIP outside services deferral.<sup>282</sup>

Similarly, regarding MECO's Customer Service expenses related to MECO's DR program, the Parties have agreed to adopt the same treatment of this issue as was approved in Docket No. 2016-0328. Specifically, on January 25, 2018, in Docket No. 2015-0412, the commission approved the HECO Companies' Revised DR Portfolio tariff structure framework, which included, in relevant part, the use of the DSM surcharge to

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<sup>280</sup>See D&O 35545 at 123-124.

<sup>281</sup>See In re Hawaiian Elec. Co., Inc., Hawaii Elec. Light Co. Inc., and Maui Elec. Co., Ltd., Docket No. 2016-0156, Order No. 35573, "Accepting the Withdrawal of the Hawaiian Electric Companies' Application and Closing the Docket," filed July 17, 2018.

<sup>282</sup>Settlement Agreement, Exhibit 1 at 59-60.

collect DR Portfolio variable costs "until such costs are approved and reflected in the Companies' respective base rates[.]"<sup>283</sup>

As a result of D&O 35238, in HECO's rate case, Docket No. 2016-0328, the Parties agreed that HECO would recover its new DR Program costs through the DSM surcharge until the commission approved the inclusion of the New DR program costs in base rates.<sup>284</sup> As noted above in Section II.B.5.ii (DSM Tariff), the Parties here have agreed to reduce MECO's 2018 Test Year estimate for DR cost forecast estimates for programs that have not been fully implemented, resulting in removal of \$2,995,000 related to MECO's Fast DR Program.<sup>285</sup> This is reflected as a downward adjustment to MECO's Customer Service expenses.<sup>286</sup>

In sum, the Parties have agreed to adjustments to MECO's Customer Service 2018 Test Year O&M expense that result in a total

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<sup>283</sup>Settlement Agreement, Exhibit 1 at 62 (citing In re Hawaiian Elec. Co., Inc., Hawaii Elec. Light Co., Inc., and Maui Elec. Co., Ltd., Docket No. 2015-0412, Decision and Order No. 35238, filed January 25, 2018) ("D&O 35238").

<sup>284</sup>See Settlement Agreement, Exhibit 1 at 63-64.

<sup>285</sup>Settlement Agreement, Exhibit 1 at 64 and 65 (corrected June 21, 2018). However, as noted above, the Parties agreed that MECO could still include \$699,000 in costs associated with incentives and ICB charges related to the Fast DR Program expansion. See Section II.B.5.ii (DSM Tariff), above; see also, Settlement Agreement, Exhibit 1 at 64-65 (corrected June 21, 2018).

<sup>286</sup>See Settlement Agreement, Exhibit 1 at 59.

downward adjustment of \$3,218,000.<sup>287</sup> Accordingly, the Parties have stipulated to a 2018 Test Year Customer Service O&M expense of \$3,519,000.<sup>288</sup>

Based on the commission's review of the record, the commission finds reasonable the Parties' 2018 Test Year Customer Service expense amounts of \$3,519,000.

viii.

#### Administrative And General

A&G expenses represent a diverse group of operation expenses, not provided for in other functional areas, and include labor and non-labor O&M expenses that cover a diverse group of NARUC block account categories, such as Administrative, Outside Services, Insurance, Employee Benefits, and Miscellaneous.<sup>289</sup>

In its Direct Testimony, MECO proposed 2018 Test Year A&G O&M expenses of \$22,344,000.<sup>290</sup> As discussed above, the Parties

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<sup>287</sup>Settlement Agreement, Exhibit 1 at 29 and 59.

<sup>288</sup>See Settlement Agreement, Exhibit 1 at 29; and Joint Statement of Probable Entitlement, Attachment 2 at 1. 6,738,000 - 3,218,000 = 3,520,000 (\$1,000 different attributed to rounding).

<sup>289</sup>See MECO Direct Testimony, MECO T-12 (Paul C. Franklin) at 21.

<sup>290</sup>Settlement Agreement, Exhibit 1 at 66 (citing MECO Direct Testimony, MECO-1201 and 1203).

have agreed to downward adjustments related to Employee Vacancy, MECO's ICB Overhead Loading, Employee Vacancy related to HECO's ICBs to MECO, and Meals, Entertainment, and Travel, which have been apportioned, in part, to MECO's A&G expenses, resulting in downward adjustments to MECO's A&G expenses of \$60,000, \$215,000, \$161,000 and \$20,000, respectively.<sup>291</sup>

Similarly, as noted above, the Customer Service Department Adjustment also impacted MECO's A&G account, with adjustments for Finance & Business Planning expenses, revised allocation of DER leadership costs, and forward-looking study cost normalization, resulting in a net downward adjustment of \$62,000 to MECO's A&G expenses.<sup>292</sup>

Additionally, the Parties agreed to adjustments to MECO's uncollectible accounts, employee benefits, and rate case expenses to incorporate updated data, resulting in downward adjustments of \$7,000, \$392,000, and \$256,000, respectively.<sup>293</sup>

The Parties also agreed to several adjustments related to MECO's pension and OPEB expenses. As discussed in Interim D&O 35631, the Parties agreed to a number of accounting adjustments to address MECO's excess pension contributions and the

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<sup>291</sup>See Settlement Agreement, Exhibit 1 at 65-66; and Section II.C.2.i (Non-Specific O&M Account Adjustments), above.

<sup>292</sup>See Settlement Agreement, Exhibit 1 at 58 and 66-67.

<sup>293</sup>See Settlement Agreement, Exhibit 1 at 65-66 and 71-72.



effects of ASU 2017-07.<sup>294</sup> In addition, the Parties have stipulated to accept the updates MECO provided for its net periodic pension cost ("NPPC") and net periodic benefit cost ("NPBC") regulatory asset/liability accounts to reflect the interim increase in rates that took place in August 2018.<sup>295</sup> The Parties' stipulations on these issues resulted in a number of adjustments to MECO's pension and OPEB costs that affect MECO's 2018 Test Year A&G expenses.<sup>296</sup> As a result, the Parties have agreed to a resulting downward adjustment of \$137,000 to MECO's pension and OPEB costs.<sup>297</sup>

The Parties also agreed to downwardly adjust MECO's estimated 401(k) contributions for the 2018 Test Year. In 2011, the HECO Companies implemented a new 401(k) retirement plan,

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<sup>294</sup>See Interim D&O 35631 at 19-26. These adjustments are related to the Parties' stipulations regarding the formation of a regulatory asset to address the impact of ASU 2017-07, which also resulted in adjustments to MECO's 2018 Test Year rate base, discussed below.

<sup>295</sup>See Settlement Agreement, Exhibit 1 at 67-68. Specifically, the NPPC and NPBC balances, which originally assumed a reset date of June 30, 2018, in MECO's Direct Testimony, were updated to reflect a reset date of August 31, 2018, consistent with the modified procedural schedule set forth in Order No. 35333. This changed the estimated December 31, 2018 end-of-year balance for the regulatory accounts, as well as the pension and OPEB amortization expenses contained in A&G. Compare MECO Direct Testimony, MECO-1210 at 2-3 and MECO-1211 at 3 with MECO response to CA-IR-403, Attachment 2 at 2 and Attachment 3 at 3. See also, Settlement Agreement, Exhibit 1 at 65 (corrected June 21, 2018), Table 22.

<sup>296</sup>See Settlement Agreement, Exhibit 1 at 67-71.

<sup>297</sup>See Settlement Agreement, Exhibit 1 at 71.

"401(k) HEIRS Plan," which took effect May 1, 2011 and applies to employees hired after April 30, 2011.<sup>298</sup> According to MECO, this new plan is not an additional retirement plant for its employees, but is intended to replace the prior, more generous retirement plan, and is applied to all employees hired on or after May 1, 2011.<sup>299</sup> As a result, MECO estimates that as of January 1, 2017, there will be annual savings of more than \$233,000.<sup>300</sup> That being said, MECO has agreed to adjust its estimated 401(k) costs by basing them on MECO's actual 2017 HEIRS contribution, plus a 3% bargaining unit wage escalation for 2018, as proposed by the Consumer Advocate.<sup>301</sup> This results in a downward adjustment of \$7,000 to MECO's 2018 Test Year expenses.<sup>302</sup>

The Parties further agree to miscellaneous adjustments to: (1) remove MECO's arbitration-legal fees expense of \$30,000, due to insufficient support; (2) decrease MECO's workers compensation claims expense by \$55,428 to reflect "more complete information produced during settlement discussions;" and

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<sup>298</sup>See Settlement Agreement, Exhibit 1 at 73.

<sup>299</sup>See Settlement Agreement, Exhibit 1 at 74.

<sup>300</sup>Settlement Agreement, Exhibit 1 at 74 (citing MECO Direct Testimony, MECO T-15 (Yannick Gagne) at 18-19 and MECO-1505).

<sup>301</sup>Settlement Agreement, Exhibit 1 at 75.

<sup>302</sup>See Settlement Agreement, Exhibit 1 at 66 (corrected June 21, 2108).

(3) increase MECO's employee benefit transfers expense by \$409,000 to reflect corrections and revisions to the estimates provided in MECO's Direct Testimony.<sup>303</sup>

Finally, regarding A&G, the Parties agreed to several adjustments to MECO's information technology ("IT") and Enterprise Resource Planning/Enterprise Asset Management ("ERP/EAM") expenses. IT expenses are shared services of the HECO Companies; similarly, the expenses for the ERP/EAM project are shared among the HECO Companies.<sup>304</sup> The Consumer Advocate proposed several adjustments to MECO's allocable share of the IT and ERP/EAM project expenses.<sup>305</sup> In the Settlement Agreement, the Parties agreed to adopt most of the Consumer Advocate's adjustments, but also agreed to increase MECO's 2018 Test Year ERP related direct non-labor

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<sup>303</sup>See Settlement Agreement, Exhibit 1 at 75-78. Regarding the legal-arbitration fees and workers compensation claims adjustments, the Settlement Agreement appears to incorrectly reflect them as "\$50,000" and "\$206,000," respectively, on page 75 of Exhibit 1 to the Settlement Agreement. The Settlement Agreement's discussion of these adjustments provide that the adjustments are \$30,000 and \$55,428, respectively; figures which are corroborated by the table on page 66 of Exhibit 1 of the Settlement Agreement (corrected June 21, 2018). Table 22 provides for "Misc. Adjs & corrections" adjustments of \$324,000.  $(\$30,000) + (\$55,428) + \$409,000 = \$323,572$ , rounded to \$324,000.

<sup>304</sup>See Settlement Agreement, Exhibit 1 at 78.

<sup>305</sup>See Settlement Agreement, Exhibit 1 at 78.

costs. The net effect of these agreements is a downward adjustment of \$18,000.<sup>306</sup>

In sum, the Parties have agreed to adjustments to MECO's A&G 2018 Test Year O&M expense that result in a total downward adjustment of \$1,012,000.<sup>307</sup> Accordingly, the Parties have stipulated to a 2018 Test Year A&G O&M expense of \$21,332,000.<sup>308</sup>

Based on the commission's review of the record, the commission finds reasonable the Parties' 2018 Test Year A&G expense amounts of \$21,332,000.

ix.

#### Customer Benefit Adjustment

As discussed in Interim D&O 35363, the Parties have reached an agreement regarding the consolidation of MECO's 2015 Filing with this Docket.<sup>309</sup> Specifically, in response to the commission's decision to transfer and consolidate MECO's 2015 Filing "to ensure that ratepayers receive the attendant

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<sup>306</sup>See Settlement Agreement, Exhibit 1 at 79 and MECO T-12, Attachment 5 at 1.

<sup>307</sup>Settlement Agreement, Exhibit 1 at 29 and 66 (corrected June 21, 2018).

<sup>308</sup>See Settlement Agreement, Exhibit 1 at 29; and Joint Statement of Probable Entitlement, Attachment 2 at 1. (22,344,000 - 1,012,000 = 21,332,000.)

<sup>309</sup>See Interim D&O 35363 at 26-31.

benefits" of MECO's pledge to forgo an opportunity to seek a general rate increase for its 2015 test year,<sup>310</sup> the Parties have agreed to a "Customer Benefit Adjustment" of \$2,256,000 (excluding taxes), to be applied in a similar fashion as was agreed to by the Parties in HECO's 2017 test year rate case, Docket No. 2016-0328. Consistent with the settlement agreement in Docket No. 2016-0328, MECO shall return the Customer Benefit Adjustment to ratepayers over the next five years, resulting in an annual revenue requirement adjustment of approximately \$451,000 (pre-tax), adjusted to \$411,000 after accounting for revenue taxes.<sup>311</sup> This is reflected as a downward adjustment of \$411,000 to MECO's O&M expenses.<sup>312</sup>

Based on the commission's review of the record, the commission finds reasonable the Parties' stipulated Customer Benefit Adjustment amount and regulatory accounting treatment.

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<sup>310</sup>Interim D&O 35363 at 26; see also Order No. 34739, "Transferring and Consolidating Docket No. 2014-0318 with Docket No. 2017-0150, and Closing Docket No. 2014-0318," filed August 14, 2017.

<sup>311</sup>See Interim D&O 35363 at 28-31; Settlement Agreement, Exhibit 1 at 133; and MECO response to PUC-MECO-IR-1, filed May 10, 2018, Attachment 1 at 1.

<sup>312</sup>Joint Statement of Probable Entitlement, Attachment 2 at 1 (the pre-tax amount of \$411,000 is utilized, as the taxes affecting this amount are captured in the separate "taxes other than income tax" category).

x.

Total O&M Expenses

Based on the above, the commission approves as reasonable the Parties' 2018 Test Year total O&M expense amount of \$235,594,000,<sup>313</sup> subject to any necessary adjustments required by the commission's modifications discussed herein.<sup>314</sup>

3.

Non-O&M Expenses

As a result of the Settlement Agreement, the Parties have stipulated to the following 2018 Test Year non-O&M expenses at proposed rates:<sup>315</sup>

Depreciation & Amortization	\$29,591,000
Amortization of State ITC	(\$1,469,000)
Taxes Other Than Income	\$31,883,000
Interest on Customer Deposits	\$145,000
Income Taxes	<u>\$8,780,000</u>
Total Non-O&M Expenses	\$68,930,000

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<sup>313</sup>See Joint Statement of Probable Entitlement, Attachment 2 at 1.

<sup>314</sup>For example, as discussed above, pursuant to D&O 36159, MECO may include its deferred O&M expenses for the Ma'alaea Project in its 2018 Test Year.

<sup>315</sup>Joint Statement of Probable Entitlement, Attachment 2 at 1.

Depreciation & Amortization

As defined by the NARUC Uniform System of Accounts ("USOA") for Class A and B Electric Utilities:

"Depreciation," as applied to depreciable utility plant, means the loss in service value not restored by current maintenance, incurred in connection with the consumption or prospective retirement of utility plant in the course of service from causes which are known to be in current operation and against which the utility is not protected by insurance. Among causes to be given consideration are wear and tear, decay, action of the elements, inadequacy, obsolescence, changes in the art, changes in demand and requirements of public authorities.<sup>316</sup>

MECO's depreciation and amortization rates utilized in its Direct Testimony were based on MECO's 2008 Book Depreciation Study, which were approved by the commission in Docket No. 2009-0286.<sup>317</sup> Subsequently, on July 30, 2018, in Docket No. 2016-0431, the commission approved new depreciation and amortization rates for the Hawaiian Electric Companies, pursuant to the Depreciation Settlement<sup>318</sup> (in anticipation, MECO provided two sets of schedules of operations and supporting

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<sup>316</sup>In re Maui Elec. Co., Ltd., Docket No. 2009-0163, Decision and Order No. 30365, filed May 2, 2012, at 55-56 (citing MECO T-14 at 3 (quoting NARUC's USOA for Class A and B Electric Utilities, at 1-2 (Definitions))).

<sup>317</sup>MECO Direct Testimony, T-17 (Tiffany A. Mukai) at 3.

<sup>318</sup>See D&O 35606.

exhibits for scenarios utilizing the "old" depreciation and amortization rates and the "new" proposed depreciation and amortization rates from Docket No. 2016-0431). In addition, as noted above, pursuant to Order No. 35276, MECO also updated its 2018 Test Year schedules and exhibits to incorporate the estimated impacts of the 2017 Tax Act.

Regarding MECO's 2018 Test Year depreciation expenses, MECO provided updates incorporating: (1) actual plant balances as of December 31, 2017; and (2) the estimated impacts of the 2017 Tax Act in its supplemental responses to CA-IR-167.<sup>319</sup> These formed the basis for the Consumer Advocate's proposed adjustments to MECO's depreciation expense.<sup>320</sup> MECO agreed to these, but proposed additional adjustments to incorporate corresponding adjustments related to its Federal Investment Tax Credit ("ITC") and Net ASC 740 Regulatory Asset.<sup>321</sup>

As a result, the Parties have stipulated to a 2018 Test Year Depreciation and Amortization expense of \$29,591,000.<sup>322</sup>

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<sup>319</sup>See Settlement Agreement, Exhibit 1 at 80-81; see also, MECO response to CA-IR-167 (March 2, 2018 Supplement, April 5, 2018 Supplement, and April 9, 2018 Supplement).

<sup>320</sup>See CA Direct Testimony, CA-T-1 (Steven C. Carver) at 80-81.

<sup>321</sup>See Settlement Agreement, Exhibit 1 at 82.

<sup>322</sup>Settlement Agreement, Exhibit 1 at 83. See also, Joint Statement of Probable Entitlement, Attachment 2 at 1.



Based on the commission's review of the record, the commission finds reasonable the Parties' 2018 Test Year Depreciation and Amortization expense amount of \$29,591,000.

ii.

Amortization Of The State Investment Tax Credit

As stated by MECO in its Direct Testimony:

The State [ITC] was enacted in 1987 under HRS § 235-110.7 and was designed to promote capital investment and to mirror the qualification rules of the old federal ITC. The 4% credit applies to qualifying equipment purchased and placed into service by businesses in Hawaii.

For book and ratemaking purposes, the credit is deferred in the year earned and subsequently amortized over the estimated useful life of the associated asset, as was done with the federal ITC. Note that the average useful life currently is 55 years based on Maui Electric's Commission-approved depreciation study in Docket No. 2009-0286. The new depreciation rates in Docket No. 2016-0431 propose an average useful life of 36 years.<sup>323</sup>

Because the Unamortized State ITC represents tax credits MECO has received, but has not yet passed on to ratepayers, it is treated as a reduction to MECO's average test year rate base.<sup>324</sup>

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<sup>323</sup>MECO Direct Testimony, MECO T-18 (Lon K. Okada) at 18-19.

<sup>324</sup>See Section II.C.5.v (Unamortized State Investment Tax Credit), below.

As MECO amortizes this balance over the life of the useful asset, it is passed on to ratepayers as a reduction to expenses.

In its Direct Testimony, MECO proposed a beginning test year unamortized ITC balance of \$15,227,000 and a 2018 Test Year amortization amount of (\$708,000).<sup>325</sup> Subsequently, MECO updated its figures to incorporate the actual December 31, 2017 account balances and updated 2018 forecasts, resulting in a revised average test year balance of \$14,974,000 and corresponding amortization amount of (\$681,000).<sup>326</sup>

In its Direct Testimony, the Consumer Advocate incorporated MECO's April 2, 2018 Supplement into its proposed adjustment; however, the Consumer Advocate also recommended accelerating the amortization period for the ITC credit balance to

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<sup>325</sup>See MECO Direct Testimony, MECO-1802 at 4 and MECO-1804 at 2.

<sup>326</sup>See MECO response to CA-IR-186 (April 2, 2018 Supplement), Attachment 11 at 2. In the Settlement Agreement, the Parties refer to a revised balance of "\$15,145,000" and corresponding amortization amount of ("341,000"). Settlement Agreement, Exhibit 1 at 87. The Parties are referring to MECO's April 2, 2018 Supplement, which utilized MECO's then-current depreciation rates, and not the updated depreciation rates approved in Docket No. 2016-0431. See MECO response to CA-IR-186, Attachment 11 at 1. As stated above, to the extent possible, the commission is utilizing figures that incorporate the updated, Docket No. 2016-0431 depreciation rates in this Decision and Order, as they are the depreciation rates which are ultimately incorporated into MECO's schedules approved herein.

ten years, resulting in an average test year balance of \$14,580,000 and an amortization amount of (\$1,470,000).<sup>327</sup>

In recommending accelerating the amortization period for the ITC to ten years, the Consumer Advocate noted that "[t]he Company's extended amortization accounting procedure has the effect of delaying ratepayer realization of the State tax credit savings that MECO enjoys immediately on its filed tax returns," and that "it is possible and may be desirable as a matter of regulatory policy to accelerate ratepayers' participation in these tax credit benefits within the early years of asset lives, when the carrying costs of undepreciated new asset balances placed into rate base represent the largest burden upon ratepayers."<sup>328</sup> According to the Consumer Advocate, "[t]his change would be income neutral to the Company, because the more rapid amortization would reduce tax expenses on the books to coincide with lower net tax expense recoveries from ratepayers."<sup>329</sup> The Consumer Advocate's

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<sup>327</sup>See CA Direct Testimony, CA-T-2 (Michael L. Brosch) at 83 and Exhibit CA-102, Schedule C-11 at 1 (it appears that the Consumer Advocate's calculations are based on MECO's prior depreciation rates); see also, Settlement Agreement, Exhibit 1 at 87.

<sup>328</sup>See CA Direct Testimony, CA-T-2 (Michael L. Brosch) at 82-83.

<sup>329</sup>CA Direct Testimony, CA-T-2 (Michael L. Brosch) at 83.

proposals would have the effect of adjusting MECO's 2018 Test Year ITC amortization amount to (\$1,470,000).<sup>330</sup>

"[F]or the purpose of reaching a global settlement," the Parties have agreed to adopt the Consumer Advocate's adjustment, including the ten-year amortization period.<sup>331</sup> As a result, the Parties have agreed to an average 2018 Test Year State ITC balance of \$14,580,000 with a corresponding 2018 Test Year amortization amount of (\$1,469,000).<sup>332</sup>

Based on the commission's review of the record, the commission finds reasonable the Parties' 2018 Test Year amortization expense of (\$1,469,000) based on an average State ITC balance of \$14,580,000.

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<sup>330</sup>Settlement Agreement, Exhibit 1 at 87.

<sup>331</sup>Settlement Agreement, Exhibit 1 at 87-88.

<sup>332</sup>See Settlement Agreement, Exhibit 1 at 88 and MECO T-18, Attachment 2; and Joint Statement of Probable Entitlement, Attachment 2 at 1. See also, CA Direct Testimony, Exhibit CA-102, Schedule C-11 at 1. The approximately \$1,000 difference between the Consumer Advocate's estimates and the figures in the Settlement Agreement is attributed to rounding and considered non-material.

iii.

Taxes Other Than Income Tax

MECO's taxes other than income tax ("TOTIT") include six taxes or fees that are related to either payroll or utility revenue:<sup>333</sup>

Payroll

1. Federal Insurance Contribution Act and Medicare tax
2. Federal Unemployment tax
3. State Unemployment tax

Utility Revenue

4. State Public Service Company tax
5. State Public Utility fee
6. County Utility Franchise tax

In its Direct Testimony, MECO proposed 2018 Test Year TOTIT expenses of \$30,704,000 at current effective rates and \$34,839,000 at proposed rates.<sup>334</sup> Subsequently, in the Settlement Agreement, the Parties agreed that a number of corresponding adjustments were necessary in light of other stipulated adjustments agreed to by the Parties. In particular, stipulated adjustments to MECO's 2018 Test Year fuel and purchased power expenses have a corresponding impact on MECO's electric sales forecast and ECAC and PPAC revenues, which, in turn, impact MECO's

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<sup>333</sup>MECO Direct Testimony, MECO T-18 (Lon K. Okada) at 2.

<sup>334</sup>MECO Direct Testimony, MECO-1801 at 2.

revenue taxes.<sup>335</sup> Similarly, MECO's payroll taxes are impacted by the stipulated adjustments to MECO's O&M labor overtime expenses and employee vacancy rate.<sup>336</sup>

As a result, the Parties have stipulated to TOTIT expenses of \$30,776,000 at current effective rates and \$31,883,000 at proposed rates.<sup>337</sup> Based on the commission's review of the record, the commission finds reasonable the Parties' agreement on this issue, subject to any necessary adjustments resulting from the commission's modifications discussed herein.

iv.

#### Interest On Customer Deposits

As stated in MECO's Direct Testimony:

Customer deposits are amounts the Company collects from customers as security for their electric service. These customers are either new customers who have not established their credit worthiness with the Company, or are past or existing customers who have failed to maintain their creditworthiness with the Company.<sup>338</sup>

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<sup>335</sup>See Settlement Agreement, Exhibit 1 at 84. Several of MECO's revenue taxes, including the State Public Service Company tax and the State Public Utility fee, are derived from MECO's gross revenues. See MECO Direct Testimony, MECO T-18 (Lon K. Okada) at 8-18.

<sup>336</sup>See Settlement Agreement, Exhibit 1 at 84.

<sup>337</sup>See Joint Statement of Probable Entitlement, Attachment 2 at 1 and 5.

<sup>338</sup>MECO Direct Testimony, MECO T-11 (Annabel R. Arase) at 66.

For those customers from whom MECO requires a customer deposit, "[t]he customer deposit is held until the customer has established a record of twelve months of continuous prompt payments, has established credit in accordance with [MECO's Tariff] Rule No. 5, has closed the account, or if service has been terminated for nonpayment of the full deposit and/or nonpayment of electric bills (in which case the deposit would be applied to the unpaid bill balance)." <sup>339</sup>

"[C]ustomers who are assessed a customer deposit receive interest on their deposit," <sup>340</sup> which is included as an expense in MECO's revenue requirement. MECO pays 6% interest on its customer deposits, "in accordance with Maui Electric Tariff Rule No. 6 and Rule 4.2.c.2.a of General Order No. 7." <sup>341</sup> MECO states that this rate "is relatively high in comparison to most, if not all, comparable rates offered by financial institutions in the current economic environment." <sup>342</sup>

In its Direct Testimony, MECO proposed a 2018 Test Year expense of \$158,000 for interest on customer deposits, based on a 6% interest rate and an average 2018 Test Year customer deposits

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<sup>339</sup>MECO Direct Testimony, MECO T-11 (Annabel R. Arase) at 66.

<sup>340</sup>MECO Direct Testimony, MECO T-11 (Annabel R. Arase) at 68.

<sup>341</sup>MECO Direct Testimony, MECO T-11 (Annabel R. Arase) at 69.

<sup>342</sup>MECO Direct Testimony, MECO T-11 (Annabel R. Arase) at 69.

balance of \$2,637,000.<sup>343</sup> In its supplemental response to CA-IR-148, filed February 21, 2018, MECO updated these figures to reflect the actual customer deposit and interest balances at December 31, 2017.<sup>344</sup> As a result, MECO proposed updating its 2018 Test Year estimates by reducing the average customer deposits balance by \$216,000 and the corresponding interest on customer deposits expense by \$12,000.<sup>345</sup>

In its Direct Testimony, the Consumer Advocate reached a similar conclusion, based on its own incorporation of MECO's actual December 31, 2017 account balances.<sup>346</sup> As a result, the Consumer Advocate proposed a corresponding decrease to MECO's 2018 Test Year interest on customer deposits expense of \$13,000, to which MECO has agreed,<sup>347</sup> resulting in a 2018 Test Year amount of \$145,000.<sup>348</sup>

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<sup>343</sup>MECO Direct Testimony, MECO T-11 (Annabel R. Arase) at 68; and MECO-1110.

<sup>344</sup>Settlement Agreement, Exhibit 1 at 88.

<sup>345</sup>See Settlement Agreement, Exhibit 1 at 88.

<sup>346</sup>See Settlement Agreement, Exhibit 1 at 94 (reflecting a proposed adjustment to customer deposits in MECO's rate base of \$216,000).

<sup>347</sup>See Settlement Agreement, Exhibit 1 at 88-89. The approximately \$1,000 difference between MECO's and the Consumer Advocate's adjustment is attributed to rounding. Id. at 89 n.103.

<sup>348</sup>See Joint Statement of Probable Entitlement, Attachment 2 at 1. (\$158,000 - \$13,000 = \$145,000).



Based on the commission's review of the record, the commission finds reasonable the Parties' 2018 Test Year stipulated interest on customer deposits of \$145,000.

v.

#### Income Taxes

On December 22, 2017, the President signed into law the 2017 Tax Act, which MECO describes as "the first comprehensive change in the law since the 1986 Tax Reform Act . . . ." <sup>349</sup> On February 9, 2018, the commission instructed MECO to update its Application to incorporate the estimated impacts of the 2017 Tax Act. <sup>350</sup> In its response, filed on February 26, 2018, and February 28, 2018, MECO noted that the most pertinent changes resulting from the 2017 Tax Act include: (1) lowering the federal corporate income tax rate from 35% to 21%, beginning December 31, 2017; (2) reducing the net operating loss deduction to 80% of taxable income; (3) limiting the deductibility of interest expense in excess of 30% of a business' adjusted taxable income plus interest income; (4) eliminating bonus depreciation for regulated utilities; (5) removing CIAC from the definition of

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<sup>349</sup>MECO Revised Schedules, filed February 26, 2018, Exhibit 1 at 1.

<sup>350</sup>See Order No. 35276.

nontaxable contributions; (6) ending the domestic production activities deduction after December 31, 2017; (7) expanding the definition of "compensation" subject to the internal revenue code section 162(m) \$1 million deduction limitation by including all performance-based compensation; and (8) reducing the amounts and scope of deductions for fringe benefit expenses.<sup>351</sup>

According to MECO, "the most significant impact of the [2017 Tax Act] is the reduction in the corporate tax rate from 35% to 21% beginning in 2018[,] . . . [which] will lower income tax expense recognized in the Company's financial statements and the income tax liability paid starting in [the] 2018 tax year."<sup>352</sup> In addition to reducing the corporate tax rate paid by MECO, "[t]he tax rate reduction results in a decrease in [Accumulated Deferred Income Tax ("ADIT")]] in order to reflect the lower income taxes payable or refundable in the future when the temporary differences (generating the ADIT) reverse."<sup>353</sup>

As a result, MECO now estimates that there is an "excess" amount of ADIT, based on the change in corporate tax rates,

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<sup>351</sup>See MECO Revised Schedules, filed February 26, 2018, Exhibit at 1-3.

<sup>352</sup>MECO Revised Schedules, filed February 26, 2018, Exhibit 1 at 3.

<sup>353</sup>MECO Revised Schedules, filed February 26, 2018, Exhibit 1 at 4. ADIT is also discussed, below, as a component to MECO's rate base.

that should be addressed. According to "guidance provided in Accounting Standards Codifications ('ASC') 740," "[i]nstead of reducing ADIT through a credit to deferred income tax expense, the accounting for the tax rate reduction would follow ratemaking, and a regulatory liability would be recorded for the rate differential (excess ADIT), representing the excess taxes collected from customers in periods prior to the rate change and expected to be returned to customers."<sup>354</sup>

In its Revised Schedules, MECO proposed dividing the excess ADIT regulatory liability into three categories, based on characteristics that affect how their benefits are passed on to customers: (1) protected excess ADIT subject to tax normalization and the Average Rate Assumption Method ("ARAM"), which would be subject to a 16-year amortization period; (2) unprotected excess ADIT related to plant, which would be subject to a 36-year amortization period; and (3) unprotected excess ADIT related to non-plant, which would be subject to a 5-year amortization period.<sup>355</sup>

In Docket No. 2016-0328, HECO and the Consumer Advocate reached an agreement on this same issue as part of their settlement

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<sup>354</sup>MECO Revised Schedules, filed February 26, 2018, Exhibit 1 at 5.

<sup>355</sup>See Settlement Agreement, Exhibit 12 at 85; see also, MECO Revised Schedules, filed February 26, 2018, Exhibit 1 at 5-9.

agreement in HECO's 2017 test year rate case, which the commission approved as part of D&O 35545.<sup>356</sup> In the HECO Settlement, HECO and the Consumer Advocate agreed to the following regulatory treatment of HECO's excess ADIT:<sup>357</sup>

- (1) Excess ADIT balances subject to ARAM will be deferred "until more accurate quantification of such amounts can be determined";<sup>358</sup>
- (2) Plant-related excess ADIT balances will be amortized over a 15-year period, utilizing balances as of December 31, 2017 that are not subject to normalization accounting restrictions; and
- (3) Non-plant-related excess ADIT balances will be amortized over a five-year period, utilizing balances as of December 31, 2017 that are not subject to normalization accounting restrictions.

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<sup>356</sup>See Settlement Agreement, Exhibit 1 at 85; see also, In re Hawaiian Electric Company, Inc., Docket No. 2016-0328, "Parties Stipulated Settlement on Remaining Issues," filed March 5, 2018 ("HECO Settlement"). See also, D&O 34454 at 48-52.

<sup>357</sup>See Settlement Agreement, Exhibit 1 at 86; see also, HECO Settlement, Exhibit 1 at 19-23.

<sup>358</sup>Regarding quantification of the excess ADIT balances subject to ARAM, MECO states that while it has all the necessary data, it has had difficulty with the calculations and intends to address this issue through the PowerTax software that is being implemented in connection with the ERP/EAM project, which was scheduled for October 2018. See MECO Revised Schedules, Exhibit 1 at 7. See also, In re Hawaiian Electric Company, Inc., Docket No. 2016-0328, "Hawaiian Electric Company, Inc. 2017 Test Year Supplemental Testimonies, Exhibits, and Workpapers," filed February 14, 2018, HECO ST-26 (Lon K. Okada) at 8-10.

In this proceeding, "[f]or purposes of this settlement agreement, the Parties agree that the amortization of the regulatory liabilities related to excess ADIT should follow the treatment [HECO] and the Consumer Advocate agreed to in their stipulation settlement on remaining issues filed on March 5, 2018."<sup>359</sup> As a result, the Parties have agreed to the following regulatory treatment for the excess ADIT regulatory liability categories:<sup>360</sup>

- (1) Amortization of ARAM excess ADIT is deferred until a more precise calculation of this balance amount can be completed;<sup>361</sup>
- (2) Amortization of non-ARAM plant-related excess ADIT over a 15-year period, resulting in a 2018 Test Year adjustment of (\$374,000) to income tax expenses; and
- (3) Amortization of non-ARAM non-plant-related excess ADIT over a five-year period, resulting in a 2018 Test Year adjustment of (\$79,000) to income tax expenses.

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<sup>359</sup>Settlement Agreement, Exhibit 1 at 86. As noted by the Parties, amortization of the excess ADIT is a component of MECO's Net ASC 740 Regulatory Asset/Liability. See id. at 83 and 87. Consequently, the revenue impacts of the Parties' stipulation on this issue are reflected in the Settlement Agreement's depreciation expenses. See id. at 83.

<sup>360</sup>Settlement Agreement, Exhibit 1 at 86-87.

<sup>361</sup>As described in n.358, above, MECO intends to use the PowerTax software to complete these calculations.

In addition to the above changes resulting from the 2017 Tax Act, the Parties note in the Settlement Agreement that the commission has adopted the "interest synchronization" method in determining interest expense deduction.<sup>362</sup> Under this approach, interest synchronization calculations are based on the average rate base and weighted cost of debt; accordingly, to the extent adjustments are made to MECO's 2018 Test Year rate base, this will result in corresponding changes to MECO's 2018 Test Year income tax expense.<sup>363</sup> Concomitantly, the Parties agree that MECO's 2018 Test Year income tax expense will "be recalculated based on the adjusted revenues and expenses as well as the synchronized interest incorporating the results of all adjustments agreed upon by the Parties."<sup>364</sup>

As a result, the Parties have stipulated to a 2018 Test Year income tax expense of \$5,851,000 at current effective rates and \$8,780,000 at proposed rates.<sup>365</sup>

Based on the commission's review of the record, as well as the commission's approval of similar regulatory tax treatment in Docket No. 2016-0328, the commission finds reasonable the

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<sup>362</sup>Settlement Agreement, Exhibit 1 at 88.

<sup>363</sup>See Settlement Agreement, Exhibit 1 at 88.

<sup>364</sup>Settlement Agreement, Exhibit 1 at 88.

<sup>365</sup>Joint Statement of Probable Entitlement, Attachment 2 at 1.

Parties' 2018 Test Year stipulated income tax expense of \$5,851,000 at current effective rates and \$8,780,000 at proposed rates, as well as the stipulated regulatory treatment for MECO's excess ADIT amounts, subject to any necessary adjustments resulting from the commission's modifications discussed herein.

vi.

Total Non-O&M Expenses

Based on the above, the commission approves as reasonable the Parties' 2018 Test Year total non-O&M expense amount of \$64,894,000 at current effective rates and \$68,930,000 at proposed rates; subject to any necessary adjustments resulting from the commission's modifications discussed herein.<sup>366</sup>

4.

Average Rate Base - Investment In Assets

"In general, rate base consists of investments, funded by both investors and non-investors, in assets that are necessary to provide reliable electric service, less funds from non-investors, plus or minus working cash."<sup>367</sup> Test year revenue

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<sup>366</sup>See Joint Statement of Probable Entitlement, Attachment 2 at 1.

<sup>367</sup>Settlement Agreement, Exhibit 1 at 90.

requirements are intended to provide utilities with an opportunity to earn a fair rate of return on their investment; consequently, funds from non-investors are subtracted in determining this amount.

In essence, rate base serves as the basis for determining the amount of investment on and of which MECO's investors should be allowed an opportunity to earn a fair and reasonable rate of return.<sup>368</sup> Accordingly, "[f]or rate case purposes, [MECO] calculated an average rate base which is the sum of average balances of investments in assets less the sum of the average balances of funds from non-investors."<sup>369</sup>

In determining MECO's average 2018 Test Year rate base, the commission notes that several broad adjustments were made to the figures initially proposed in MECO's Direct Testimony. First, as noted above, on February 26, 2018, and February 28, 2018, MECO updated its testimony, exhibits, and schedules to incorporate the estimated impacts of the 2017 Tax Act, pursuant to Order No. 35276.<sup>370</sup> This had the effect of adjusting a number of rate base components, including the Unamortized Net ASC

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<sup>368</sup>Settlement Agreement, Exhibit 1 at 90.

<sup>369</sup>Settlement Agreement, Exhibit 1 at 90.

<sup>370</sup>See MECO Revised Schedules.



740 Regulatory Asset, working cash, and ADIT at current effective rates.<sup>371</sup>

Second, on March 16, 2018, and April 2, 2018, in response to CA-IR-186, MECO provided updated exhibits and workpapers that replaced estimated 2017 end-of-year balances with actual December 31, 2017 balances.<sup>372</sup> This had the effect of further adjusting a number of rate base components, including Net Plant-in-Service, Materials & Supplies Inventories, Pension Tracking Regulatory Asset, Unamortized System Development Costs & Other Deferred Costs, Contributions in Excess of NPPC Regulatory Asset, Unamortized CIAC, Customer Advances, Customer Deposits, and OPEB Regulatory Liability.<sup>373</sup>

Thereafter, following the above adjustments, the Parties stipulated to a number of additional adjustments in the Settlement Agreement which further adjusted MECO's average 2018 Test Year rate base, as discussed below.

Pursuant to the Settlement Agreement, the Parties have stipulated to the following 2018 Test Year average rate base:<sup>374</sup>

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<sup>371</sup>See MECO Revised Schedules, filed February 28, 2018, MECO-213, Attachment 6 at 13.

<sup>372</sup>See MECO response to CA-IR-186 (March 16, 2018 Supplement and April 2, 2018 Supplement), Attachments 1-11.

<sup>373</sup>See MECO response to CA-IR-186, (March 16, 2018 Supplement), Attachment 2 at 5.

<sup>374</sup>Joint Statement of Probable Entitlement, Attachment 2 at 3.

	Beginning Balance	End of Year Balance	Average Balance
<b>Investment in Assets Serving Customers</b>			
Net Cost of Plant in Service	\$630,341,000	\$679,663,000	\$655,002,000
Property Held for Future Use	\$1,303,000	\$1,303,000	\$1,303,000
Fuel Inventory	\$9,375,000	\$9,375,000	\$9,375,000
Mater. & Suppl. Inventories	\$16,799,000	\$16,799,000	\$16,799,000
Unamort. Net ASC 740 Reg. Asset	(\$44,548,000)	(\$43,899,000)	(\$44,224,000)
Pension Tracking Reg. Asset	\$12,682,000	\$12,071,000	\$12,377,000
Pension Non- Service Cost	\$0	\$270,000	\$135,000
Unamort. Sys. Develop. Costs	\$2,595,000	\$263,000	\$1,429,000
Contrib. in Excess of NPPC	\$1,034,000	\$1,034,000	\$1,034,000
<b>Total Invest. in Assets</b>	<b>\$629,581,000</b>	<b>\$676,879,000</b>	<b>\$653,230,000</b>
<b>Funds From Non-Investors</b>			
Unamort. CIAC	\$102,684,000	\$108,860,000	\$105,772,000
Customer Advances	\$9,764,000	\$10,775,000	\$10,270,000
Customer Deposits	\$2,569,000	\$2,274,000	\$2,422,000
ADIT	\$56,265,000	\$58,284,000	\$57,275,000
Unamort. State ITC (Gross)	\$14,695,000	\$14,465,000	\$14,580,000

Unamort. Gain on Sales	\$0	\$0	\$0
Pension Reg. Liability	\$0	\$0	\$0
OPEB Reg. Liability	\$2,513,000	\$2,684,000	\$2,599,000
<b>Total Deductions</b>	<b>\$188,490,000</b>	<b>\$197,342,000</b>	<b>\$192,916,000</b>
<b>Difference</b>			<b>\$460,314,000</b>
Working Cash at Curr. Eff. Rates			<b>\$2,233,000</b>
<b>Rate Base at Curr. Eff. Rates</b>			<b>\$462,547,000</b>
Change in Rate Base - Working Cash			<b>(\$175,000)</b>
<b>Rate Base at Proposed Rates</b>			<b>\$462,372,000</b>

i.

#### Net Plant-In-Service

According to MECO's Direct Testimony, "[n]et cost of plant in service consists of the gross plant in service less accumulated depreciation, removal regulatory liability, and asset retirement obligation ('ARO')." <sup>375</sup>

In general, MECO begins with its gross plant-in-service, which is the original cost of plant assets, including "the cost of equipment, construction, and all other costs necessary for

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<sup>375</sup>MECO Direct Testimony, MECO-2014 at 2.

the projects and investments to be used and useful for public utility purposes."<sup>376</sup>

To this, MECO then applies "accumulated depreciation," which represents the "cumulative amount of depreciation that has been expensed in the past."<sup>377</sup> Depreciation, in turn, "is the allocation of a portion of the original cost of the asset to each period in the estimated useful life of [the] asset."<sup>378</sup> Included in accumulated depreciation are removal expenses, such as Retirement Work in Progress ("RWIP"), removal regulatory liability, and ARO, which act as offsets to accumulated depreciation, as they represent costs incurred by the utility to remove assets that are no longer used or useful (i.e., they reduce the amount of accumulated depreciation which is applied to reach net plant-in-service).<sup>379</sup>

In essence, as an asset loses value over time, this loss in value is recorded as a depreciation expense, which the utility records as both a decrease to gross plant-in-service and an increase in expenses. The utility may continue to include the

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<sup>376</sup>MECO Direct Testimony, MECO-2014 at 2.

<sup>377</sup>MECO Direct Testimony, MECO-2014 at 2.

<sup>378</sup>MECO Direct Testimony, MECO-2014 at 2; see also, Section II.C.3.i (Depreciation & Amortization), above.

<sup>379</sup>See MECO Direct Testimony, MECO-2014 at 2-3; see also, id. at MECO T-17 (Tiffaney A. Mukai) at 8-9.

undepreciated value of the asset in its rate base; however, the value of the asset will continue to depreciate every year. The corresponding decrease in value is recorded as a depreciation expense, which the utility recovers as part of its non-O&M expenses (as discussed in Section II.C.3.i (Depreciation & Amortization), above).

In sum, net plant-in-service "represents the Company's unrecovered investment in plant that is used and useful and necessary to provide electric service."<sup>380</sup> "In determining Net Cost of Plant in Service for an average rate base for a calendar based test year, the Company takes the beginning balance of Net Cost of Plant in Service as of December 31 of the year just prior to the test year and the ending balance of Net Cost of Plant in Service as of December 31 of the test year and averages the two balances."<sup>381</sup>

In its Direct Testimony, MECO proposed an average net plant-in-service amount of \$657,076,000.<sup>382</sup> Subsequently, MECO updated this figure by incorporating the actual net plant-in-service balance as of December 31, 2017, as well as

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<sup>380</sup>MECO Direct Testimony, MECO-2014 at 3.

<sup>381</sup>MECO Direct Testimony, MECO-2014 at 3.

<sup>382</sup>See Settlement Agreement, Exhibit 1 at 93.

updates to its 2018 forecast.<sup>383</sup> In its Direct Testimony, the Consumer Advocate proposed an adjustment to net plant-in-service based on these updated figures.<sup>384</sup>

In the Settlement Agreement, the Parties have agreed to adopt the figures which incorporate the actual December 31, 2017 balances and updated 2018 forecast.<sup>385</sup> As a result, the Parties have stipulated to a 2018 Test Year average balance of \$655,002,000.<sup>386</sup>

Based on the commission's review of the record, the commission finds the Parties' 2018 Test Year stipulated average net-plant-in-service balance of \$655,002,000 to be reasonable, with the exception of the commission's modifications related to the Substation Projects.<sup>387</sup>

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<sup>383</sup>See MECO response to CA-IR-167 (March 16, 2018 Supplement).

<sup>384</sup>See Settlement Agreement, Exhibit 1 at 94; see also, CA Direct Testimony, Exhibit CA-102, Schedule B-1. The Consumer Advocate's adjustments appear to be based on MECO's 2018 Test Year estimates incorporating the existing depreciation rates, not the new depreciation rates approved in Docket No. 2016-0431. See id. at footnote (a).

<sup>385</sup>See Settlement Agreement, Exhibit 1 at 95.

<sup>386</sup>See Settlement Agreement, Exhibit 1 at 93 and MECO T-20 at 1; see also, Joint Statement of Probable Entitlement, Attachment 2 at 3.

<sup>387</sup>As discussed above, MECO shall remove the costs associated with the Ka'ono'ulu Project and the Substation Land component of the Kuihelani Project from its 2018 Test Year.

Property Held For Future Use

"Property held for future use represents the Company's investment in property needed to provide electric service in the future."<sup>388</sup> Property held for future use is determined by taking the beginning balance "as of December 31 of the year just prior to the test year and the ending balance . . . as of December 31 of the test year and average[ing] the two balances."<sup>389</sup>

In its Direct Testimony, MECO included \$1,303,000 for property purchased in Waena in 1996 to accommodate a future site for generation capacity.<sup>390</sup> This amount was apparently unaffected by MECO's subsequent update to incorporate actual December 31, 2017 account balances and updated 2018 forecasts.<sup>391</sup> Similarly, the Consumer Advocate did not recommend any adjustments to this amount and the Parties have stipulated to a 2018 Test Year average amount of \$1,303,000 in the Settlement Agreement.<sup>392</sup>

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<sup>388</sup>MECO Direct Testimony, MECO-2014 at 3.

<sup>389</sup>MECO Direct Testimony, MECO-2014 at 3.

<sup>390</sup>See MECO Direct Testimony, MECO-2014 at 3; see also, MECO Direct Testimony, MECO T-8 (Matthew M. McNeff) at 31.

<sup>391</sup>See MECO response to CA-IR-186 (March 16, 2018 Supplement).

<sup>392</sup>See Settlement Agreement, Exhibit 1 at 93; see also, Joint Statement of Probable Entitlement, Attachment 2 at 3.

Based on the commission's review of the record, the commission finds the Parties' 2018 Test Year stipulated average property held for future use balance of \$1,303,000 to be reasonable.

iii.

#### Fuel Inventory

"Fuel inventory is the Company's investment in a supply of fuel held in inventory[,] which is necessary "to ensure a sufficient supply of fuel for the Company's power plants[.]"<sup>393</sup> "The test year average Fuel Inventory is determined based on the volume in inventory needed to reliably service customers and the fuel price assumptions."<sup>394</sup>

In its Direct Testimony, MECO proposed an average 2018 Test Year Fuel Inventory balance of \$9,224,000, which consisted of \$8,327,000 for MECO's Maui Division, \$503,000 for the Lanai Division, and \$394,000 for the Molokai Division.<sup>395</sup> Subsequently, as noted in the discussion regarding the Parties' stipulated 2018 Test Year fuel expense, MECO later updated its

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<sup>393</sup>MECO Direct Testimony, MECO-2014 at 3.

<sup>394</sup>MECO Direct Testimony, MECO-2014 at 3.

<sup>395</sup>Settlement Agreement, Exhibit 1 at 102.



fuel consumption expenses.<sup>396</sup> The Parties have agreed to make corresponding adjustments to MECO's 2018 Test Year Fuel Inventory, including updating the Maui Division's fuel inventory costs to \$8,536,000, Lanai Division's to \$447,000, and Molokai Division's to \$392,000.<sup>397</sup> Accordingly, the Parties have stipulated to an average 2018 Test Year Fuel Inventory balance of \$9,375,000.<sup>398</sup>

Based on the commission's review of the record, the commission finds the Parties' 2018 Test Year stipulated average Fuel Inventory balance of \$9,375,000 to be reasonable.

iv.

#### Materials & Supplies Inventories

"Materials and supplies inventories include production inventory and transmission and distribution ('T&D') inventory."<sup>399</sup> Materials & Supply Inventories are determined by taking the beginning balance "as of December 31 of the year just prior to the test year and the ending balance . . . as of December 31 of the test year and average[ing] the two balances."<sup>400</sup>

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<sup>396</sup>See Section II.C.2.ii (Fuel), above.

<sup>397</sup>See Settlement Agreement, Exhibit 1 at 103-04.

<sup>398</sup>See Settlement Agreement, Exhibit 1 at 102; see also, Joint Statement of Probable Entitlement, Attachment 2 at 3.

<sup>399</sup>MECO Direct Testimony, MECO-2014 at 4.

<sup>400</sup>MECO Direct Testimony, MECO-2014 at 4.

In its Direct Testimony, MECO included \$15,984,000 for Materials & Supplies Inventories.<sup>401</sup> As noted above, MECO subsequently provided supplements to its Direct Testimony figures to incorporate actual December 31, 2017 account balances and updated 2018 forecasts,<sup>402</sup> which the Consumer Advocate does not contest.<sup>403</sup> As a result, the Parties have stipulated to an average 2018 Test Year Materials & Supplies Inventories balance of \$16,799,000.<sup>404</sup>

Based on the commission's review of the record, the commission finds the Parties' stipulated average 2018 Test Year Materials & Supplies Inventories balance of \$16,799,000 to be reasonable.

v.

Unamortized Net ASC 740 Regulatory Asset/Liability

As MECO states in its Direct Testimony:

The Unamortized Net ASC 740 Regulatory Asset is an accounting asset that arose due to the reporting requirements of ASC 740 . . . [which] requires the debt portion of

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<sup>401</sup>See Settlement Agreement, Exhibit 1 at 93.

<sup>402</sup>See MECO response to CA-IR-186 (March 16, 2018 Supplement).

<sup>403</sup>Compare MECO response to CA-IR-186 (March 16, 2018 Supplement), Attachment 2 at 5 with Settlement Agreement, Exhibit 1 at 93.

<sup>404</sup>See Settlement Agreement, Exhibit 1 at 93; see also, Joint Statement of Probable Entitlement, Attachment 2 at 3.

[Allowance for Funds Used During Construction ("AFUDC")], as well as any other item previously recorded on a net-of-tax basis, to be calculated and capitalized on a gross-of-tax basis. As a result, plant in service would have increased by the tax effect of the debt portion of AFUDC. However, instead of increasing plant in service, ASC 740 requires this gross-up adjustment to a regulatory asset, with the offsetting credit to the deferred income tax liability account. Because the regulatory asset is offset by the corresponding increase in accumulated deferred income taxes, there is no net rate base impact.<sup>405</sup>

In its Direct Testimony, MECO included \$8,992,000 for the Unamortized Net ASC 740 Regulatory Asset/Liability.<sup>406</sup> As noted above, MECO subsequently provided supplements to its Direct Testimony figures to incorporate the estimated impacts of the 2017 Tax Act, the actual December 31, 2017 account balances and updated 2018 forecasts, and the new depreciation rates approved in Docket No. 2016-0431.<sup>407</sup> Regarding the Unamortized Net ASC 740 Regulatory Asset/Liability, MECO's adjustments resulted in transforming the average 2018 Test Year Unamortized Net ASC 740

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<sup>405</sup>MECO Direct Testimony, MECO-2014 at 5 (emphasis in the original).

<sup>406</sup>See Settlement Agreement, Exhibit 1 at 93.

<sup>407</sup>See MECO response to CA-IR-186 (April 2, 2018 Supplement); and MECO Revised Schedules, filed February 28, 2018; see also, Settlement Agreement, Exhibit 1 at 82-83 and 111.

Asset/Liability balance negative, which now acts as a decrease to rate base of (\$44,224,000).<sup>408</sup>

As a result, the Parties have stipulated to an average 2018 Test Year Unamortized Net ASC 740 Regulatory Asset/Liability balance of (\$44,224,000).<sup>409</sup> Based on the commission's review of the record, the commission finds the Parties' stipulated average 2018 Test Year Unamortized Net ASC 740 Regulatory Asset/Liability balance of (\$44,224,000) to be reasonable.

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<sup>408</sup>See Settlement Agreement, Exhibit 1 at 82 and 93. In reaching this amount, several sets of updated figures were utilized. The Consumer Advocate relied on MECO's February 26, 2018 Revised Schedules based on the former, then-current, depreciation rates in calculating its adjusted Regulatory Asset balance of (\$44,216,000). See CA Direct Testimony, CA-T-1 (Steven C. Carver), Exhibit CA-102, Schedule B at 1 footnote (a). Subsequently, MECO provided updated figures in its April 2, 2018 supplemental response to CA-IR-186, which included schedules incorporating the Docket No. 2016-0431 depreciation rates. See MECO response to CA-IR-186 (April 2, 2018 Supplement), Attachment 2 at 5. Thereafter, in the Settlement Agreement, the Parties agreed to further update MECO's April 2, 2018 figures to incorporate additional changes to the 2018 Test Year amortization amount resulting from the Docket No. 2016-0431 depreciation rates (specifically, the extension to average service life). See Settlement Agreement, Exhibit 1 at 82.

<sup>409</sup>See Settlement Agreement, Exhibit 1 at 93; see also, Joint Statement of Probable Entitlement, Attachment 2 at 3.

Pension Tracking Regulatory Asset

"The Pension Tracking Regulatory Asset is the cumulative difference between the actuarially calculated NPPC during a rate effective period and the Commission approved NPPC included in rates ('NPPC in rates') for that rate effective period, tracked under the pension tracking mechanism approved by the Commission[.]"<sup>410</sup>

Phrased another way, "[t]he Pension Tracking Regulatory Asset represents the cumulative amount of actual NPPC calculated and recognized in a rate effective period in excess of the cumulative amount of ratepayer-provided funds recovered in rates during the same period."<sup>411</sup> Consequently, it is included as part of rate base "because it represents costs which have not yet been paid for by customers[;]" i.e., NPPC which the Company has incurred, but which are not covered by existing rates.<sup>412</sup>

In its Direct Testimony, MECO included a 2018 Test Year average of \$12,032,000 for its Pension Tracking Regulatory Asset.<sup>413</sup> As noted above, MECO subsequently provided supplements to its Direct Testimony figures to incorporate actual

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<sup>410</sup>MECO Direct Testimony, MECO-2014 at 6.

<sup>411</sup>MECO Direct Testimony, MECO-2014 at 6.

<sup>412</sup>HECO Direct Testimony, HECO-2704 at 6.

<sup>413</sup>See Settlement Agreement, Exhibit 1 at 93; see also, MECO Direct Testimony, MECO-2002 at 1.

December 31, 2017 account balances and updated 2018 forecasts.<sup>414</sup> As part of its updated 2018 forecasts, MECO revised its NPPC balance to support an interim decision and order by August 13, 2018, as contemplated by Order No. 35333.<sup>415</sup> As a result, MECO's average 2018 Test Year Pension Regulatory Asset balance was revised to \$12,377,000.<sup>416</sup> (Additionally, as noted above, this had the effect of adjusting MECO's amortized pension tracker costs within MECO's A&G expense to \$2,587,000).<sup>417</sup>

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<sup>414</sup>See MECO response to CA-IR-186 (March 16, 2018 Supplement).

<sup>415</sup>See MECO response to CA-IR-403. In its Direct Testimony, MECO had assumed a NPPC/NPBC reset date of June 30, 2018. MECO Direct Testimony, MECO-1210 at 3, n.2. However, Order No. 35333 provided for an interim decision and order by August 13, 2018, see Order No. 35333 at 43, and MECO's interim rates went into effect on August 23, 2018. See Interim D&O 35631 at 57-58 and MECO Interim Rate Tariffs.

As a result, MECO updated its estimates to reflect a 2018 NPPC balance as of August 31, 2018, which had the effect of increasing MECO's test year NPPC amortization expense and estimated 2018 NPPC end-of-year balance. See MECO response to CA-IR-403, Attachment 2 at 2; see also, Settlement Agreement, Exhibit 1 at 97, Table 28.

<sup>416</sup>See Settlement Agreement, Exhibit 1 at 97; see also, MECO response to CA-IR-186, Attachment 5 at 2 (March 16, 2018 Supplement).

<sup>417</sup>See Section II.C.2.viii (A&G), above; see also, Settlement Agreement, Exhibit 1 at 69-71 and 97; and MECO response to CA-IR-186, Attachment 5 at 2 (March 16, 2018 Supplement) (calculating amortization amount of \$2,587,000).

The Consumer Advocate did not dispute these figures and incorporated them into its Direct Testimony.<sup>418</sup>

As a result, MECO updated its average 2018 Test Year Pension Tracking Regulatory Asset balance to \$12,377,000.<sup>419</sup> Accordingly, the Parties have stipulated to an average 2018 Test Year Pension Tracking Regulatory Asset balance of \$12,377,000.<sup>420</sup>

MECO has also included a Pension Non-Service Cost component to its rate base, which arises as a result of ASU 2017-07. As discussed in Interim D&O 35631, "[o]n March 10, 2018, the Federal Accounting Standards Board issued [ASU] 2017-07, which changes the presentation of NPPC and NPBC on the financial statements and disclosures required for defined benefits plans."<sup>421</sup> As a result, only the service cost

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<sup>418</sup>See CA Direct Testimony, CA-T-1 (Steven C. Carver) at 40-42.

<sup>419</sup>See MECO response to CA-IR-186 (March 16, 2018 Supplement), Attachment 2 at 1; see also, Settlement Agreement, Exhibit 1 at 93 and MECO T-20, Attachment 2 at 1.

<sup>420</sup>See Settlement Agreement, Exhibit 1 at 93; see also, Joint Statement of Probable Entitlement, Attachment 2 at 3. In addition, as noted above, issues relating to the Pension and OPEB Tracking Regulatory Asset/Liability balances arising from MECO's 2015 abbreviated rate case filing have been addressed by the Parties' stipulated Customer Benefit Adjustment, which is applied as a line item adjustment to MECO's 2018 Test Year O&M expenses, and not as an adjustment to MECO's 2018 Test Year Pension Tracking Regulatory Asset balance.

<sup>421</sup>Interim D&O 35631 at 22 (citing MECO Direct Testimony, MECO T-12 (Paul C. Franklin) at 38).

components of MECO's NPPC and NPBC can be capitalized, while non-service costs (i.e., interest cost, expected return, amortization of transition obligation, amortization of prior service cost, and amortization of (gain)/loss)) must be charged to expenses.<sup>422</sup> For financial reporting purposes, MECO implemented ASU 2017-07 beginning January 1, 2018; however for ratemaking purposes, MECO notes that there is a lag in effect, since MECO's rates on January 1, 2018, were based on MECO's prior 2012 rate case proceeding and did not account for the ASU 2017-07 change (ASU 2017-07 was not incorporated into MECO's rates until the effective date of its interim tariff pursuant to Interim D&O 35631, which took effect on August 23, 2018).<sup>423</sup>

The issue of incorporating the impact of ASU 2017-07 arose previously in both HELCO's and HECO's prior rate cases, Docket Nos. 2015-0170 and 2016-0328, respectively, and the Parties have agreed to apply similar treatment for MECO's 2018 Test Year.<sup>424</sup> As a result, the Parties have agreed to revise MECO's "Pension Non-Service Cost" 2018 ending balance and average 2018 Test Year balance to reflect the same regulatory accounting

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<sup>422</sup>CA Direct Testimony, CA-T-1 (Steven C. Carver) at 56.

<sup>423</sup>See Interim D&O 35631 at 22-26; and MECO Interim Tariffs.

<sup>424</sup>See Settlement Agreement, Exhibit 1 at 99-100.



method negotiated in HELCO's and HECO's preceding rate cases.<sup>425</sup> Accordingly, the Parties have stipulated to an average Pension Non-Service Cost balance of \$135,000 which is incorporated into MECO's 2018 Test Year rate base.<sup>426</sup>

Based on the commission's review of the record, the commission finds the Parties' stipulated average 2018 Test Year Pension Tracking Regulatory Asset balance of \$12,377,000 and Pension Non-Service Cost Regulatory Asset balance of \$135,000 to be reasonable.

vii.

#### Deferred System Development Costs & Other Deferred Costs

According to MECO, "[d]eferred system development costs consist of the unamortized portion of computer software development project costs for which Commission approval has been obtained to defer and amortize these costs for ratemaking purposes."<sup>427</sup> Essentially, investors front costs to develop computer software systems which are expected to be in service

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<sup>425</sup>See Settlement Agreement, Exhibit 1 at 96 and 98-100. As noted above, this stipulation is also reflected as an adjustment to MECO's A&G expenses. See Settlement Agreement, Exhibit 1 at 67-71.

<sup>426</sup>See Joint Statement of Probable Entitlement, Attachment 2 at 3.

<sup>427</sup>MECO Direct Testimony, MECO-2014 at 4.

during the test year; thus, including unamortized system development costs in rate base allows investors the opportunity to earn a fair return on their investment.<sup>428</sup>

In addition, MECO seeks recovery of other deferred costs, including "the unamortized portion of costs deferred for the [PSIP] deferred consultant costs and the low load modification projects [i.e., the Ma`alaea Project] . . . for which Commission approval has been requested but not yet approved."<sup>429</sup>

In its Direct Testimony, MECO proposed \$9,793,000 in Deferred System Development Costs & Other Deferred Costs.<sup>430</sup> Subsequently, as noted above, MECO updated its Direct Testimony figures to incorporate actual December 31, 2017 account balances

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<sup>428</sup>See MECO Direct Testimony, MECO-2014 at 4-5.

<sup>429</sup>MECO Direct Testimony, MECO-2014 at 4. Although MECO initially referenced the Ma`alaea Project within the "Other Deferred Costs" portion of its Direct Testimony, recovery of the costs for the Ma`alaea Project was not effectuated through this category of rate base. As noted above, in the Settlement Agreement, the Parties agreed to include the actual plant additions for the Ma`alaea Project recorded in 2017 in MECO's average 2018 Test Year average rate base in the beginning and ending net cost of plant balances, while leaving the issue of MECO's request to defer the O&M expenses for the Project to be determined in Docket No. 2016-0345. See Settlement Agreement, Exhibit 1 at 51 and 106. As the commission ultimately ruled in Docket No. 2016-0345 that MECO could defer the O&M expenses, but excluded the unamortized expense balance from rate base, see D&O 36159, none of the Ma`alaea Project's costs are included in MECO's 2018 Test Year rate base as "deferred" or "other" costs.

<sup>430</sup>See Settlement Agreement, Exhibit 1 at 93.

and updated 2018 forecasts.<sup>431</sup> Additionally, regarding "other deferred costs," consistent with the settlement agreement in the HECO rate case, Docket No. 2016-0328, MECO has removed its PSIP deferred costs from its 2018 average Test Year rate base.<sup>432</sup> Furthermore, as discussed in Interim D&O 35631, the Parties have agreed to include the actual plant additions for the Ma`alaea Project in MECO's average 2018 Test Year rate base.<sup>433</sup>

As a result, the Parties have stipulated to an average 2018 Test Year Unamortized System Development & Other Costs balance of \$1,429,000.<sup>434</sup> Based on the commission's review of the record, the commission finds the Parties' stipulated average 2018 Test Year Unamortized System Development & Other Costs balance of \$1,429,000 to be reasonable, subject to any necessary adjustments resulting from the commission's modifications discussed herein.<sup>435</sup>

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<sup>431</sup>See MECO response to CA-IR-186 (March 16, 2018 Supplement).

<sup>432</sup>See MECO response to CA-IR-186 (March 16, 2018 Supplement), Attachment 7 at 1 n.H.

<sup>433</sup>See Interim D&O 35631 at 49-52; see also, Settlement Agreement, Exhibit 1 at 49-51 and 104-107. The issue of including the plant additions for the Ma`alaea Project are distinct from MECO's companion request to recover its O&M expenses for the Ma`alaea Project, which are separately addressed in Section II.B.4 (Cost Recovery Issues Related To Docket No. 2016-0345), above.

<sup>434</sup>See Settlement Agreement, Exhibit 1 at 93; see also, Joint Statement of Probable Entitlement, Attachment 2 at 3.

<sup>435</sup>For example, as discussed above, now that the sale amount for the Paia Land Sale has been made public, MECO shall properly categorize the associated revenues, which may involve adjustments

Contributions In Excess Of NPPC

As stated in MECO's Direct Testimony:

Contributions in Excess of NPPC Regulatory Asset represent the cumulative amounts of contribution to the pension trust made in excess of the cumulative pension cost (NPPC accrual). The NPPC is actuarially calculated in accordance with the guidance provided by Financial Accounting Standards Board ASC 715, formerly Financial Accounting Standard 87. NPPC represents the annual amount that the Company must recognize on its financial statements as the cost of providing pension benefits to its employees for the year, and includes amounts ultimately charged both to expense and capital. It is the current period charge for the pension plan and is calculated based on the actuarial assumptions of pension obligation, economic performance of the fund investment, and amortization of prior period amounts.<sup>436</sup>

In its Direct Testimony, MECO proposed a Contributions in Excess of NPPC Regulatory Asset balance of \$2,946,000.<sup>437</sup> Subsequently, this figure was adjusted by MECO's response to CA-IR-186 to reflect actual balances as of December 31, 2017 and updated 2018 estimates.<sup>438</sup>

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to this revenue requirement category and potentially other categories (e.g., gain on sale of land). See Section II.C.1.ii (Other Operating Revenue), above.

<sup>436</sup>MECO Direct Testimony, MECO-2014 at 5.

<sup>437</sup>See Settlement Agreement, Exhibit 1 at 93.

<sup>438</sup>See MECO response to CA-IR-186 (March 16, 2018 Supplement).

MECO's contributions in excess of NPPC were the subject of an interim adjustment in Interim D&O 35631.<sup>439</sup> Briefly, MECO, as part of its 2012 test year rate case, was authorized to create a regulatory asset for its contributions in excess of NPPC. MECO was authorized to commence amortization of this excess amount in 2012; however, based on MECO's 2015 test year abbreviated filing, it does not appear that MECO recorded any amortization from 2012 through 2014.<sup>440</sup> Allowing MECO to begin amortizing this amount as part of its 2018 Test Year would ultimately increase Test Year expenses.

A similar issue regarding HECO's contributions in excess of NPPC arose in HECO's recent rate case, Docket No. 2016-0328, in which the commission found that allowing HECO to begin amortizing its excess pension contributions in its 2017 test year would unfairly require HECO's ratepayers to bear an increase in test year expenses arising from HECO's oversight by not beginning to amortize its excess pension contributions beginning in 2011.<sup>441</sup>

In Docket No. 2016-0328, the commission instructed HECO to revise its test year figures such that HECO would absorb the

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<sup>439</sup>See Interim D&O 35631 at 19-22.

<sup>440</sup>See Order No. 34739 at 18 n.31.

<sup>441</sup>See Interim D&O 35100 at 23-28.

losses associated with the neglected amortization expenses.<sup>442</sup> As a result, HECO and the Consumer Advocate proposed an agreement regarding regulatory treatment for HECO's excess pension contributions in which: (1) HECO would remove the excess pension contribution amortization amount from its 2017 test year expenses; but, (2) HECO would be able to use the excess pension contribution balance amount to decrease its annual NPPC costs (subject to federal minimum contribution limits established by the Employment Retirement Income Security Act of 1974).<sup>443</sup> HECO estimated that it would exhaust its excess pension contribution balance in this manner within its first year; accordingly, the Parties agreed to allow HECO to include one-third of its excess pension contribution balance into the 2017 test year rate base to reflect that portion of the balance that would provide a benefit to ratepayers.<sup>444</sup>

In the Settlement Agreement, the Parties have agreed to adopt the same regulatory treatment for MECO's contributions in

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<sup>442</sup>Interim D&O 35100 at 27-28.

<sup>443</sup>See Interim D&O 35100 at 129-30. By using the excess pension contribution balance to decrease HECO's annual NPPC costs, this will reduce the amount of NPPC costs later sought to be recovered from ratepayers in HECO's next rate case.

<sup>444</sup>See Interim D&O 35100 at 129-30. The one-third proportion is based on HECO's triennial rate case cycle, in which HECO would apply for new rates based on a new test year every third year. As noted above, HECO anticipates using all of the excess contribution balance during the first year of its triennial rate case cycle.

excess of NPPC.<sup>445</sup> As a result, MECO has: (1) removed the amortization of its contributions in excess of NPPC from its 2018 Test Year A&G expenses; and (2) included one-third of the balance amount in the 2018 Test Year rate base.<sup>446</sup> Based on the above, the Parties have stipulated to an average 2018 Test Year Contributions in Excess of NPPC Regulatory Asset balance of \$1,034,000 for 2018 Test Year.<sup>447</sup>

Based on the commission's review of the record, as well as the commissions' approval of a similar issue in Docket No. 2016-0328, the commission finds the Parties' stipulated average 2018 Test Year Contributions in Excess of NPPC Regulatory Asset balance of \$1,034,000 to be reasonable.

5.

Average Rate Base - Funds From Non-Investors

In addition to revenues from ratepayers, MECO receives funds from other sources, including CIAC from third parties, advances from customers ahead of the provision of services,

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<sup>445</sup>Settlement Agreement, Exhibit 1 at 100-01.

<sup>446</sup>See Settlement Agreement, Exhibit 1 at 67-71 and 100-01.

<sup>447</sup>See Settlement Agreement, Exhibit 1 at 93; see also Joint Statement of Probable Entitlement, Attachment 2 at 1. \$1,034,000 represents one-third of MECO's initially proposed regulatory asset balance of \$3,101,000. See Settlement Agreement, Exhibit 1 at 97, Table 28, "Contributions in Excess of NPPC Regulatory Asset."

tax credits, and revenues resulting from the deferral of income taxes. As these revenues are not provided by the utility's investors, they are excluded from the utility's rate base. Accordingly, funds from non-investors are included in the determination of the utility's rate base and offset funds provided by investors, thereby decreasing rate base.

i.

Unamortized CIAC

CIAC "is money or property that a developer or customer contributes to the Company to fund a utility capital project."<sup>448</sup> As a source of funds from non-investors, "CIAC is included as a deduction from investments in assets funded by investors in determining rate base."<sup>449</sup>

In its Direct Testimony, MECO proposed an average Unamortized CIAC balance of \$105,401,000.<sup>450</sup> Subsequently, as noted above, MECO updated its Direct Testimony figures to incorporate actual December 31, 2017 account balances and updated 2018 forecasts.<sup>451</sup> Furthermore, regarding Unamortized CIAC,

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<sup>448</sup>MECO Direct Testimony, MECO-2014 at 7.

<sup>449</sup>MECO Direct Testimony, MECO 2014 at 7.

<sup>450</sup>See Settlement Agreement, Exhibit 1 at 93.

<sup>451</sup>See MECO response to CA-IR-186 (March 16, 2018 Supplement).



on April 9, 2018, in its supplement to its response to CA-IR-167, MECO further updated its Unamortized CIAC balance to adjust for some of the impacts of the updated depreciation rates arising from Docket No. 2016-0431,<sup>452</sup> which the Consumer Advocate does not appear to dispute.<sup>453</sup>

As a result, the Parties have stipulated to an average 2018 Test Year Unamortized CIAC balance of \$105,772,000.<sup>454</sup> Based on the commission's review of the record, the commission finds the Parties' stipulated average 2018 Test Year Unamortized CIAC balance of \$105,772,000 to be reasonable.

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<sup>452</sup>See MECO response to CA-IR-167 (April 9, 2018 Supplement) at 2 and Attachment 16.

<sup>453</sup>See MECO response to CA-IR-167 (April 9, 2018 Supplement, Attachment 16 at 2 (updating the annual CIAC amortization)); MECO response to CA-IR-186 (March 16, 2018 Supplement), Attachment 8 at 2; and Settlement Agreement, Exhibit 1 at 93. When the updated annual CIAC amortization figure is incorporated into the Unamortized CIAC calculations provided to Attachment 8, the result is the stipulated 2018 Test Year amount reflected in the Settlement Agreement.

<sup>454</sup>See Settlement Agreement, Exhibit 1 at 93; see also, Joint Statement of Probable Entitlement, Attachment 2 at 3.

ii.

Customer Advances

"Customer Advances are funds paid by customers to the Company which may be refunded in whole or in part as specified in the Company's tariff."<sup>455</sup> Similar to CIAC, as funds from non-investors, Customer Advances are included as a deduction from investments in assets funded by investors in determining rate base.

In its Direct Testimony, MECO proposed an average Customer Advances balance of \$8,264,000.<sup>456</sup> Subsequently, as noted above, MECO updated its Direct Testimony figures to incorporate actual December 31, 2017 account balances and updated 2018 forecasts,<sup>457</sup> which the Consumer Advocate does not appear to dispute.<sup>458</sup>

As a result, the Parties have stipulated to an average 2018 Test Year Customer Advances balance of \$10,270,000.<sup>459</sup>

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<sup>455</sup>MECO Direct Testimony, MECO-2014 at 7.

<sup>456</sup>See Settlement Agreement, Exhibit 1 at 93.

<sup>457</sup>See MECO response to CA-IR-186 (March 16, 2018 Supplement).

<sup>458</sup>Compare MECO response to CA-IR-186 (March 16, 2018 Supplement), Attachment 2 at 5 with Settlement Agreement, Exhibit 1 at 93.

<sup>459</sup>See Settlement Agreement, Exhibit 1 at 93; see also, Joint Statement of Probable Entitlement, Attachment 2 at 3 (the difference of approximately \$1,000 between the Settlement Agreement and Joint Statement of Probable Entitlement is attributed to rounding).

Based on the commission's review of the record, the commission finds the Parties' stipulated average 2018 Test Year Customer Advances balance of \$10,270,000 to be reasonable.

iii.

#### Customer Deposits

"Customer Deposits are monies collected from customers who do not meet the Company's criteria for establishing credit at the time they request service."<sup>460</sup> Similar to other non-investor funds, Customer Deposits are included as a reduction to rate base.

In its Direct Testimony, MECO proposed an average Customer Deposits balance of \$2,638,000.<sup>461</sup> Subsequently, as noted above, MECO updated its Direct Testimony figures to incorporate actual December 31, 2017 account balances and updated 2018 forecasts,<sup>462</sup> which the Consumer Advocate does not appear to dispute.<sup>463</sup>

As a result, the Parties have stipulated to an average 2018 Test Year Customer Deposits balance of \$2,422,000.<sup>464</sup> Based on

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<sup>460</sup>MECO Direct Testimony, MECO-2014 at 7.

<sup>461</sup>See Settlement Agreement, Exhibit 1 at 93.

<sup>462</sup>See MECO response to CA-IR-186 (March 16, 2018 Supplement).

<sup>463</sup>Compare MECO response to CA-IR-186, Attachment 2 at 5 with Settlement Agreement, Exhibit 1 at 93.

<sup>464</sup>See Settlement Agreement, Exhibit 1 at 93; see also, Joint Statement of Probable Entitlement, Attachment 2 at 3

the commission's review of the record, the commission finds the Parties' stipulated average 2018 Test Year Customer Deposits balance of \$2,422,000 to be reasonable.

iv.

Accumulated Deferred Income Taxes

As described in MECO's Direct Testimony:

ADIT represents the cumulative amount by which tax expense has exceeded tax remittances. This is primarily due to tax timing differences resulting from differences between depreciation and accelerated depreciation recorded for accounting purposes and those used for the calculation of income taxes. ADIT funds are provided by ratepayers. Although rates are established based on income tax expense, tax remittances to the government on a cumulative basis have been lower than the taxes collected through rates. As a result, ratepayers have funded the ADIT balance. Over time, the Company will eventually pay the government the amounts recorded as deferred income taxes. ADIT is reflected as a deduction from investments in assets funded by investors in determining rate base.<sup>465</sup>

In its Direct Testimony, MECO proposed an average 2018 Test Year ADIT balance of \$117,315,000.<sup>466</sup> Subsequently, as noted above, MECO updated its Direct Testimony figures several

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(the difference of approximately \$1,000 between the Settlement Agreement and Joint Statement of Probable Entitlement is attributed to rounding).

<sup>465</sup>MECO Direct Testimony, MECO 2014 at 8.

<sup>466</sup>See Settlement Agreement, Exhibit 1 at 93.

times to incorporate: (1) the estimated impacts of the 2017 Tax Act;<sup>467</sup> and (2) the actual December 31, 2017 account balances and updated 2018 forecasts.<sup>468</sup> In addition, MECO included additional adjustments to account for corresponding changes to other expenses and costs in the Settlement Agreement.<sup>469</sup>

As a result, the Parties have stipulated to an average 2018 Test Year ADIT balance of \$57,275,000.<sup>470</sup> Based on the commission's review of the record, the commission finds the Parties' stipulated average 2018 Test Year ADIT balance of \$57,275,000 to be reasonable.

v.

#### Unamortized State Investment Tax Credit

"Unamortized Investment Tax Credits are tax credits which reduce tax payments in the year the credit originates, but which are amortized for ratemaking purposes."<sup>471</sup> Similar to ADIT, unamortized ITCs are funds provided by ratepayers that result from

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<sup>467</sup>See Revised Schedules, filed February 28, 2018, MECO-213, Attachment 6 at 13.

<sup>468</sup>See MECO response to CA-IR-186 (April 2, 2018 Supplement).

<sup>469</sup>See Settlement Agreement, Exhibit 1 at 111 and MECO T-18, Attachment 1 at 3.

<sup>470</sup>See Settlement Agreement, Exhibit 1 at 93; see also, Joint Statement of Probable Entitlement, Attachment 2 at 3.

<sup>471</sup>MECO Direct Testimony, MECO-2014 at 8.

the difference in timing between when the credits are taken for the purpose of calculating taxes for the government and when adjustments are made to the income tax expense for ratemaking purposes.<sup>472</sup> Thus, the ITC is a deduction to rate base.

As discussed in Section II.C.3.ii ("Amortization of the State Investment Tax Credit"), the Parties have agreed to accept the Consumer Advocate's adjustments to MECO's average 2018 Test Year State ITC balance, which incorporates MECO's actual December 31, 2017 account balances and updated 2018 forecasts, as well as the Consumer Advocate's accelerated ten-year amortization period.<sup>473</sup> As a result, the Parties have stipulated to an average 2018 Test Year Unamortized State ITC of \$14,580,000.<sup>474</sup>

Based on the commission's review of the record, the commission finds the Parties' stipulated average 2018 Test Year Unamortized State ITC balance of \$14,580,000 to be reasonable.

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<sup>472</sup>MECO Direct Testimony, MECO-2014 at 8.

<sup>473</sup>See Settlement Agreement, Exhibit 1 at 87-88.

<sup>474</sup>See Settlement Agreement, Exhibit 1 at 93; and Joint Statement of Probable Entitlement, Attachment 2 at 3.

Unamortized Gain On Sale (Of Land)

As noted above in Section II.C.1.ii (Other Operating Revenue), the Parties have stipulated to specific regulatory treatment for MECO's gains from the Paia Land Sale. However, due to the confidential nature of the sale amount at the time the Settlement Agreement was filed, the Parties agreed to incorporate this amount into MECO's 2018 Test Year revenue requirement in such a way as to obscure the actual sale amount (the Paia Land Sale amount has since been made public and MECO filed supplemental material on August 13, 2018 disclosing these amounts). Consequently, these amounts were not reflected in unamortized gain on sales, which reflects an average 2018 Test Year balance of \$0.

As discussed above, the Parties agreed that MECO would amortize the sale amount over three years, with the unamortized balance being deducted from rate base.<sup>475</sup> In particular, MECO has incorporated a deduction of \$958,000 to its Other Deferred Costs to account for the decrease to its test year rate base.<sup>476</sup>

As stated above, based on the commission's review of the record, the commission finds the Parties' stipulations regarding

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<sup>475</sup>See Section II.C.1.ii (Other Operating Revenue), above; see also, Settlement Agreement, Exhibit 1 at 25 and 109.

<sup>476</sup>See Settlement Agreement, MECO T-12, Attachment 7 (August 13, 2018 Supplement) at 1.

the Paia Land Sale reasonable. However, now that the results of the Paia Land Sale have been made public, it may be necessary for MECO to update this category in its revised schedules of operations.<sup>477</sup>

vii.

#### OPEB Regulatory Liability

As described by MECO:

The OPEB Regulatory Liability (or regulatory asset) is the cumulative difference between the actuarially calculated net periodic benefit costs ("NPBC") during a rate effective period and the Commission approved postretirement benefits other than pension costs included in rates ("OPEB costs in rates") for that rate effective period, tracked under the OPEB tracking mechanism . . . .

The NPBC is the annual amount that the Company must recognize on its financial statements as the cost of providing post-employment benefits other than pension to its employees for the year, and includes the amount ultimately charged primarily to both expense and to capital. It is the current period charge for the OPEB plan, and is calculated based on the actuarial assumptions of the OPEB obligation, the economic performance of the fund investment and the amortization of prior period amounts.

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<sup>477</sup>As discussed above, now that the sale amount for Paia Land Sale has been made public, MECO shall properly categorize the associated revenues, which may involve adjustments to this revenue requirement category and potentially other categories (e.g., gain on sale of land). See Section II.C.1.ii (Other Operating Revenue), above.



An OPEB Regulatory Liability represents the actual cumulative NPBC included in rates over a rate effective period in excess of the actual cumulative NPBC during the same period. The OPEB tracking mechanism ensures that the OPEB costs recovered through rates are based on the NPBC as reported for financial reporting purposes and that all amounts contributed to the OPEB trust funds are in an amount equal to the actual OPEB cost and are recoverable through rates.

The OPEB Regulatory Liability represents the cumulative excess amount of OPEB costs in rates during a rate effective period over the actuarially calculated NPBC recognized during that same period. As the amount consists of funds from non-investors, it is a deduction in the calculation of rate base, as required under the OPEB tracking mechanism.<sup>478</sup>

In its Direct Testimony, MECO proposed an average 2018 Test Year OPEB Regulatory Liability balance of \$2,510,000.<sup>479</sup> Subsequently, as noted above, MECO updated its Direct Testimony to incorporate the actual December 31, 2017 account balances and updated 2018 forecasts.<sup>480</sup> As part of its updated 2018 forecasts, MECO revised its NPBC balance to support an interim decision and order by August 13, 2018, as contemplated by Order No. 35333.<sup>481</sup>

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<sup>478</sup>MECO Direct Testimony, MECO-2014 at 9.

<sup>479</sup>See Settlement Agreement, Exhibit 1 at 93.

<sup>480</sup>See MECO response to CA-IR-186 (March 16, 2018 Supplement); see also, MECO response to CA-IR-403.

<sup>481</sup>See MECO response to CA-IR-403. In its Direct Testimony, MECO had assumed a NPPC/NPBC reset date of June 30, 2018. MECO Direct Testimony, MECO-1210 at 3 n.2. However, Order No. 35333 provided for an interim decision and order by August 13, 2018. See Order No. 35333 at 43. As a result,

As a result, MECO's average 2018 Test Year OPEB Regulatory Liability balance was revised to (\$2,599,000).<sup>482</sup> Additionally, as noted above, this had the effect of adjusting MECO's amortized OPEB costs within MECO's A&G expense to (\$575,000).<sup>483</sup> The Consumer Advocate did not dispute these figures and incorporated them into its Direct Testimony.<sup>484</sup>

As a result, the Parties have stipulated to an average 2018 Test Year OPEB Regulatory Liability balance of (\$2,599,000) and test year amortization expense of (\$575,000).<sup>485</sup> Based on the commission's review of the record, the commission finds reasonable the Parties' stipulated average 2018 Test Year OPEB Regulatory Liability balance of \$2,599,000 and test year amortization expense of \$575,000..

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MECO updated its estimates to reflect a 2018 NPBC balance as of August 31, 2018, which had the effect of increasing MECO's test year NPBC amortization expense and estimated 2018 NPBC end-of-year balance. See MECO response to CA-IR-403, Attachment 3 at 3; see also, Settlement Agreement, Exhibit 1 at 71, Table 23 and 97-98, Table 28.

<sup>482</sup>See Settlement Agreement, Exhibit 1 at 98; see also, MECO response to CA-IR-186 (March 16, 2018 Supplement), Attachment 6 at 3; and MECO response to CA-IR-403, Attachment 3 at 3. As this figure is negative, it represents a liability to MECO and is included as an offset to its test year rate base.

<sup>483</sup>See Section II.C.2.viii (A&G), above; see also, Settlement Agreement, Exhibit 1 at 69-71.

<sup>484</sup>See CA Direct Testimony, CA-T-1 (Steven C. Carver) at 40-42.

<sup>485</sup>See Settlement Agreement, Exhibit 1 at 93; see also, Joint Statement of Probable Entitlement, Attachment 2 at 3.

Average Rate Base - Working Cash

As described by MECO:

The Company's primary source of cash inflow is electric revenues. The primary cash outflow is for the payment of expenses. Working cash addresses these cash flows. Working cash is the capital over and above investments in plant and other rate base items to cover the cost of providing service to the Company's customers. It bridges the gap between the time the Company pays for the expenses incurred to provide electric service and the time customers pay for the electric service provided.

It is included in rate base because it represents an investment that enables the Company to pay suppliers and conduct other business activities necessary to provide electric service to consumers without interruption. Working Cash is essential capital necessary for smooth fiscal operations. The inclusion of this essential capital in rate base recognizes the carrying cost to investors of monies that the Company needs to have on hand as a result of gaps in the timing of cash flows through the Company.<sup>486</sup>

MECO utilizes a lead-lag approach to calculate working cash, in which MECO "uses the date on which service is provided to the customer as the starting point in calculating both the collection lag days and payment lag days for a Working Cash

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<sup>486</sup>MECO Direct Testimony, MECO-2014 at 9.

component to the end points when cash is received or paid."<sup>487</sup> MECO performed lead-lag studies for the following expense categories: fuel, purchased, power, O&M labor, O&M non-labor, revenue taxes, and income taxes.<sup>488</sup> This methodology is consistent with HECO's previous rate cases.<sup>489</sup>

For purposes of calculating Working Cash for its 2018 Test Year, MECO has excluded amortization of regulatory assets and liabilities and allowance for uncollectible accounts.<sup>490</sup> Although MECO maintains that these revenues and expenses should be included in the Working Cash calculation, "in the interest of simplifying the issues and expediting the regulatory process in this case . . . [MECO] has excluded these amortizations and the allowance from the Working Cash calculation."<sup>491</sup> However, MECO included amortization of regulatory commission expense in the

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<sup>487</sup>MECO Direct Testimony, MECO-2014 at 9.

<sup>488</sup>MECO Direct Testimony, MECO-2014 at 10.

<sup>489</sup>MECO Direct Testimony, MECO-2014 at 11.

<sup>490</sup>MECO Direct Testimony, MECO-2014 at 11.

<sup>491</sup>MECO Direct Testimony, MECO-2014 at 11. MECO notes that in the past, similar items have been disallowed by the commission as part of the Working Cash calculation, "primarily on the grounds that these non-cash items do not involve cash outlays in the test year." Id., MECO T-20 (Teri Y. Kam) at 12. MECO maintains that "all revenues and all expenses should be included in the working cash calculation[,]" regardless if the cash outlay occurs outside of the test year, and expressly reserves the right to seek recovery of similar amounts in future rate case proceedings. See id.

amount of \$674,000 as part of O&M non-labor Working Cash calculation on the basis that: (1) regulatory commission expense is a cash outlay occurring before, during, and potentially after the test year; and (2) such treatment is proposed in lieu of including a regulatory asset for regulatory commission expense.<sup>492</sup>

In its Direct Testimony, the Consumer Advocate maintained that MECO's regulatory commission expense should also be excluded from the Working Cash calculation, on the basis that "all amortizations (e.g., the pension asset, the pension/OPEB regulatory asset/liability, other regulatory amortizations and regulatory commission expense amortizations) . . . represent non-cash transactions recorded by the Company . . . [and] [a]s a matter of longstanding policy and practice, the [c]ommission has determined that non-cash expenses not requiring current period cash payments should be excluded from cash working capital studies."<sup>493</sup> In addition, the Consumer Advocate also proposed adjusting MECO's Working Cash income tax component to reflect the changes related to the implementation of the 2017 Tax Act,

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<sup>492</sup>MECO Direct Testimony, MECO T-20 (Teri Y. Kam) at 13.

<sup>493</sup>CA Direct Testimony, CA-T-1 (Steven C. Carver) at 98-99 (emphasis in the original) (footnotes excluded).

including a reduced income tax rate and corresponding increase in composite income tax payment lag.<sup>494</sup>

As part of the Settlement Agreement, MECO has agreed to the Consumer Advocate's proposals, including the income tax calculation adjustments to reflect the 2017 Tax Act and excluding the \$674,000 in amortization of regulatory commission expense.<sup>495</sup> However, MECO continues to expressly reserve the right to take a different position on this issue in future rate case proceedings.<sup>496</sup>

In the Settlement Agreement, the Parties agreed to "recalculate the working cash component of rate base to include the impact of all settlement issues[] in their joint or separate statement of probable entitlement filings."<sup>497</sup> As a result, in their Joint Statement of Probable Entitlement, the Parties have stipulated to a Working Cash average 2018 Test Year balance of

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<sup>494</sup>See CA Direct Testimony, CA-T-1 (Steven C. Carver) at 97; and Settlement Agreement, Exhibit 1 at 107. The Consumer Advocate also noted that the 2017 Tax Act resulted in "currently negative income taxes," but maintained that as this does not represent a use of cash, a value of "\$0" should be used in applicable calculations (rather than a negative amount). See CA Direct Testimony, CA-T-1 (Steven C. Carver) at 97.

<sup>495</sup>Settlement Agreement, Exhibit 1 at 107-08.

<sup>496</sup>Settlement Agreement, Exhibit 1 at 108.

<sup>497</sup>Settlement Agreement, Exhibit 1 at 109.

\$2,233,000 at current effective rates and \$2,058,000 at proposed rates, representing a change in working cash of (\$175,000).<sup>498</sup>

Based on the commission's review of the record, the commission finds reasonable the Parties' stipulated average 2018 Test Year working cash balance of \$2,233,000 at current effective rates and \$2,058,000 at proposed rates, respectively.

7.

#### Test Year Average Rate Base

In sum, the commission approves as reasonable the Parties' stipulated 2018 Test Year average rate base of \$462,547,000 and \$462,372,000 at current effective and proposed rates, respectively, subject to any necessary adjustments resulting from the commission's modifications discussed herein.

8.

#### Rate Of Return

As discussed by the Hawaii Supreme Court:

A fair return is the percentage rate of earnings on the rate base allowed a utility after making provision for operating expenses, depreciation, taxes and other direct operating costs. Out of such allowance the utility must pay interest and other fixed dividends on preferred and common stock. In determining a

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<sup>498</sup>See Joint Statement of Probable Entitlement, Attachment 2 at 3, 13, 26, and 39.

rate of return, the Commission must protect the interests of a utility's investors so as to induce them to provide the funds needed to purchase plant and equipment, and protect the interests of the utility's consumers so that they pay no more than is reasonable.

To calculate the rate of return, the costs of each component of capital - debt, preferred equity and common equity - are weighted according to the ratio each bears to the total capital structure of the company and the resultant figures are added together to yield a sum which is the rate of return.

The proper return to be accorded common equity is the most difficult and least exact calculation in the whole rate of return procedure since there is no contractual cost as in the case of debt or preferred stock[:]

Equity capital does not always pay dividends; all profits after fixed charges accrue to it and it must withstand all losses. The cost of such capital cannot be read or computed directly from the company's books. Its determination involves a judgment of what return on equity is necessary to enable the utility to attract enough equity capital to satisfy its service obligations.

. . . . .

Questions concerning a fair rate of return are particularly vexing as the reasonableness of rates is not determined by a fixed formula but is a fact question requiring the exercise of sound discretion by the Commission. It is often recognized that the ratemaking function involves the making of "pragmatic" adjustments and that there is no single correct rate of return but that there is a "zone of



reasonableness" within which the commission may exercise its judgment.<sup>499</sup>

As noted above, the Parties have stipulated to a ROE of 9.50%, resulting in an overall rate of return on average rate base of 7.43%, which the commission previously approved as part of Interim D&O 35631.<sup>500</sup> Accordingly, the commission approves as fair the Parties' stipulated ROE of 9.50% and corresponding rate of return of 7.43%.

9.

Revenue Allocation And Rate Design

Several customer class revenue allocation and rate design proposals, including supporting cost of service studies, were submitted in this proceeding. As discussed below, the commission finds that the rate class revenue allocation principle and rate design provisions stipulated to by the Parties in the Settlement Agreement are reasonable, under the circumstances contemplated therein.

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<sup>499</sup>In re Hawaii Elec. Light Co., Inc., 60 Haw. 625, 632-33 and 636, 594 P.2d 612, 618-20 (1979) (citations omitted).

<sup>500</sup>See ROE Settlement; and Interim D&O 35631.

i.

MECO

MECO prepared two types of cost of service studies ("COS") for this proceeding: one based on embedded, or accounting, costs, and the other based on marginal energy costs.<sup>501</sup>

As described by MECO:

An embedded [COS], or simply referred to as a cost of service study, is a process used to categorize and allocate the total utility costs of providing service (the utility's total revenue requirements) to the various rate classes in order to determine each class's cost responsibility. In contrast, a marginal cost study determines the change in the utility's costs of providing service due to a unit change in kilowatts ("kW"), kilowatt-hours ("kWh"), or number of customers served by the utility.<sup>502</sup>

As the Company has done in previous cost of service presentations, MECO presented the results of two embedded COS methodologies for its distribution network costs: (1) the minimum system method used by the Hawaiian Electric Companies, where the distribution lines, poles, conductors, and transformers are classified as partly demand-related and partly customer-related; and (2) the Consumer Advocate's preferred method of classifying all distribution network costs as demand-related.<sup>503</sup>

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<sup>501</sup>MECO Direct Testimony, MECO T-23 (Peter C. Young) at 8.

<sup>502</sup>MECO Direct Testimony, MECO T-23 (Peter C. Young) at 9.

<sup>503</sup>MECO Direct Testimony, MECO T-23 (Peter C. Young) at 9.

The results of MECO's COS are summarized, in pertinent part, in the following exhibits: (1) MECO-2309, MECO-2311, and MECO-2313 show the results for the minimum system method for Maui division, Lanai division, and Molokai division, respectively, applying the new depreciation rates approved in Docket No. 2016-0431; and (2) MECO-2310, MECO-2312, and MECO-2314 show the results for the method of classifying all distribution networks as demand-related for the Maui division, Lanai division, and Molokai division, respectively, applying the new depreciation rates approved in Docket No. 2016-0431.<sup>504</sup> These exhibits provide summaries of the following information:

- (A) A comparison of each rate class's revenues and rates of return at current effective rates and at proposed rates, and show the proposed revenue increase and the proposed percentage increase in revenue for each rate class;
- (B) Each rate class's demand, energy, and customer cost components at proposed rates;
- (C) Each rate class's unit demand, energy, and customer cost components at proposed rates; and
- (D) The allocation factors for the three cost components, demand, energy, and customer.<sup>505</sup>

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<sup>504</sup>See MECO Direct Testimony, MECO T-23 (Peter C. Young) at 10-11.

<sup>505</sup>See MECO Direct Testimony, MECO T-23 (Peter C. Young) at 11.

MECO states that "an allocation of revenue increase to divisions strictly according to cost of service would have required large bill increases for customers at the Lana`i and Moloka`i divisions."<sup>506</sup> "Therefore, to avoid significant hardship for customers at the Lana`i and Moloka`i divisions, and to balance the revenue and bill impact across all Maui Electric customers, the Company proposes the same percentage increase over revenues at current effective rates for each division and for each rate class at each division."<sup>507</sup>

The conversion of the revenue increases discussed above into a pricing structure for each of MECO's rate classes is the subject of MECO's rate design. In developing its rate design, MECO states that it typically considers: (1) production of the Company's test-year revenue requirement; (2) each class's cost of service; (3) revenue stability; (4) rate stability and rate continuity; (5) impact on customers; (6) customer's choice; (7) provision of fair and equitable rates; (8) simplicity, ease of understanding, and ease of implementation; and (9) encouragement of customer load management.<sup>508</sup> As summarized by MECO, "[i]n general, changes to Maui Electric's rates are aimed at

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<sup>506</sup>MECO Direct Testimony, MECO T-23 (Peter C. Young) at 12.

<sup>507</sup>MECO Direct Testimony, MECO T-23 (Peter C. Young) at 12.

<sup>508</sup>MECO Direct Testimony, MECO T-23 (Peter C. Young) at 22.

aligning the rate elements closer to the cost components, minimizing intra-class subsidy, and moving closer to more efficient pricing that provides more accurate price signals."<sup>509</sup>

According to MECO:

The proposed rate schedules and rate structure are the same as proposed in the test year 2012 rate case (with the exception of the optional time of use rate schedules which will be discussed below); however, the rate levels proposed in the test year 2018 rate design are different and recover the test year 2018 revenue requirements. Generally speaking, the proposed test year 2018 rate design tries to reduce the dollar amount of customer costs and demand costs that would otherwise need to be recovered in energy charges by proposing increases to customer charge rates and/or demand charge rates.<sup>510</sup>

Concomitantly, MECO proposes a "simplified rate design:"

Maui Electric uses the term "simplified rate design" to mean that all regular commercial rate schedules have a single energy charge rate and a single demand charge rate. Commercial customers are separated by kW load into small Schedule G customers (customer monthly kW  $\leq$  25 kW and kWh  $\leq$  5,000 per month), medium Schedule J customers (25 kW < customer monthly kW < 200 kW), and large Schedule P customers (customer monthly kW  $\geq$  200 kW).<sup>511</sup> Street light service is offered on commercial Schedule F. Residential service on Schedule R is proposed to continue the three pricing tiers based on usage, for the

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<sup>509</sup>MECO Direct Testimony, MECO T-23 (Peter C. Young) at 23.

<sup>510</sup>MECO Direct Testimony, MECO T-23 (Peter C. Young) at 23.

<sup>511</sup>For the Molokai division, customers move from Schedule J to Schedule P at 100 kW of demand. MECO Direct Testimony, MECO T-23 (Peter C. Young) at 24 n.5.

first 350 kWh per month, the next 850 kWh per month, and all kWh above 1,200 kWh per month at the Maui division; and for the first 250 kWh per month, the next 500 kWh per month, and all kWh above 750 kWh per month at the Lana`i division and Moloka`i division.<sup>512</sup>

In general, MECO proposed a rate design under which customer charges and demand charges for each division will recover the same percentage of the 2018 Test Year unit class cost-of-service as was recovered in MECO's 2012 test year final rates, with the balance of proposed revenues for each rate class recovered through the energy charge (to the extent revenues are not recovered by any of the other rate elements or rate adjustments, such as the ECAC, PPAC, or RAM/RBA mechanisms).<sup>513</sup> While this would not immediately improve the economics of the price signals by recovering a higher percentage of customer costs through the customer charge and demand charge, MECO contends that it would nonetheless result in an increase in the dollar amount associated with the customer charge and demand charge, which would ultimately reduce the dollar amount of costs that would otherwise need to be recovered through energy charge rates.<sup>514</sup>

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<sup>512</sup>MECO Direct Testimony, MECO T-23 (Peter C. Young) at 23-24.

<sup>513</sup>MECO Direct Testimony, MECO T-23 (Peter C. Young) at 25. For MECO's specific proposed dollar amount increases, see id. at 26-30. See also, Settlement Agreement, Exhibit 1 at 119-122.

<sup>514</sup>See MECO Direct Testimony, MECO T-23 (Peter C. Young) at 25.

MECO also proposed changes to its optional time of use ("TOU") rates. For Residential Customers, MECO proposes modifying Schedule TOU-R (the original residential TOU service option) and Schedule TOU EV (the original residential TOU service option for customers with electric vehicles), as well as Schedule TOU-RI (the residential interim TOU program that replaced Schedule TOU-R and Schedule TOU EV).<sup>515</sup> Briefly:

The Company proposes to modify Schedule TOU-R and Schedule TOU-EV such that the revised rates for these rate schedules have the same relationship to Schedule R rates as the existing rates for Schedule TOU-R and Schedule TOU EV have relative to the existing rates for Schedule R.

. . . . .  
[Regarding Schedule TOU-RI,] [f]or each Maui Electric division, the Company proposes to modify the time-of-use charges based on the applicable 2018 cost of service values for Schedule R, consistent with the approved rate determination . . . . . The proposed customer charges and minimum charges are modified to match the same respective charges in the proposed Schedule R rates, also consistent with the approved rate determination. Maui Electric proposes to modify the proposed Schedule TOU-RI rate designs in this proceeding to be aligned with the rate methodologies determined in the DER proceeding

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<sup>515</sup>MECO Direct Testimony, MECO T-23 (Peter C. Young) at 31. Schedules TOU-R and TOU EV were closed to enrollment effective September 16, 2016, by commission action in the DER proceeding. See In re Public Util. Comm'n, Docket No. 2014-0192, Order No. 33923, "Instructing the Hawaiian Electric Companies to Submit Tariffs for an Interim Time-Of-Use Program," filed September 16, 2016 ("Order No. 33923").

or any other separate proceeding where such residential time-of-use rate option designs are considered for all the Hawaiian Electric Companies.<sup>516</sup>

For Commercial Customers, MECO proposed modifying Schedules TOU-G (Small Commercial TOU), TOU-J (Commercial TOU), and TOU-P (Large Power TOU) such that:

The proposed structures for Schedules TOU-G, TOU-J, and TOU-P will have the same three daily time-of-use rating periods for energy charges as the existing Schedule TOU-RI: On-Peak is 5pm to 10pm, daily; Off-Peak is 10pm to 9am, daily; and Mid-Day is 9am to 5pm, daily. The discounts and premiums relative to the regular rate schedules in the existing Schedules TOU-G, TOU-J, and TOU-P are retained in the proposed modified rates. However, the discounts and premiums are re-distributed among rating periods such that, similar to Schedule TOU-RI, rates per kWh are lowest during the Mid-Day period and highest during the On-Peak period. In addition, for Schedules TOU-J and TOU-P, the demand charge rates and the determination of demand are modified to be the same as the regular Schedule J and Schedule P, respectively.<sup>517</sup>

MECO indicated that this represents "a cautious approach to modification of commercial time-of-use rates[,] and that it, along with the other Hawaiian Electric Companies, plan to propose

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<sup>516</sup>MECO Direct Testimony, MECO T-23 (Peter C. Young) at 31-32.

<sup>517</sup>MECO Direct Testimony, MECO T-23 (Peter C. Young) at 33.



revised commercial TOU rate options as part of Phase 2 in the DER proceeding, Docket No. 2014-0192.<sup>518</sup>

MECO also proposed to modify the rates for Schedule EV-F (Commercial Public Electric Vehicle Charging Facility Service Pilot) to ensure that the energy charge rates are "consistent with the methodology proposed in Docket No. 2016-0168, where the Hawaiian Electric Companies requested an extension to the Schedule EV-F and Schedule EV-U pilot rates."<sup>519</sup> MECO also suggested closing Rider T (Time-of-Day Service) to new customers out of a desire to shift its TOU options to a rate design with three rating periods (Rider T only has two TOU rating periods).<sup>520</sup>

In addition to modified rates, MECO also proposed "modifications to the terminology used in the Availability, Minimum Charge, Determination of Demand, Power Factor, and applicable surcharge sections of certain base rate tariffs to improve the clarity and understanding of the tariffs without altering the material terms of the tariffs or the billing calculations."<sup>521</sup>

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<sup>518</sup>See MECO Direct Testimony, MECO T-23 (Peter C. Young) at 33-34.

<sup>519</sup>MECO Direct Testimony, MECO T-23 (Peter C. Young) at 34-35.

<sup>520</sup>MECO Direct Testimony, MECO T-23 (Peter C. Young) at 35.

<sup>521</sup>MECO Direct Testimony, MECO T-23 (Peter C. Young) at 31.

The Consumer Advocate

The Consumer Advocate cautioned:

Cost of service study results are only estimates that are based upon methods and judgments of cost analysts that can be controversial. In addition, [COS] results can change significantly from one test period to another, due to shifts in load conditions, varying expense levels or cost allocation methodology changes. Therefore, cost of service results should be used only as a "guide" in the general direction rate changes should occur, while other factors must be considered by the Commission.<sup>522</sup>

In particular, the Consumer Advocate maintains that "the large influx of [DER] has dramatically impacted load conditions and class revenue and income levels, particularly within the Residential customer class, causing the Company's [COS] results to be of little guidance value in distributing revenue responsibility[.]"<sup>523</sup> Consequently, the Consumer Advocate contends that "[t]he value and accuracy of embedded [COS] results is now greatly diminished, in comparison to the role of [COS] results in

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<sup>522</sup>CA Direct Testimony; CA-T-2 (Michael L. Brosch) at 101.

<sup>523</sup>CA Direct Testimony, CA-T-2 (Michael L. Brosch) at 101. The Consumer Advocate contends that in addition to COS results, other rate design considerations include: (1) revenue stability and adequacy for the utility; (2) gradualism in customer impacts; (3) administrative practicality; and (4) public policy priorities such as conservation, economic development or low-income assistance. Id. at 102.

prior rate cases[,]” and “there are much larger concerns arising from the emergence of large sub-classes of customers within each traditional customer class that employ DER which significantly impact the energy usage patterns and revenue contributions to fixed costs for the entire class.”<sup>524</sup>

In this regard, the Consumer Advocate notes that the traditional COS studies utilized by MECO “continue to apply the traditional customer classes that combine all residential, commercial, industrial and lighting customers into large classes without regard to how customers’ load characteristics and revenues within each class have been impacted by DER.”<sup>525</sup> While acknowledging that this issue is being considered in the commission’s DER proceeding, Docket No. 2014-0192, the Consumer Advocate observes that MECO’s COS relies on traditional classifications of customer classes and is not supportive of an “unbundled rate design to facilitate the cost effective and beneficial integration of DER onto Hawaii’s electric grids.”<sup>526</sup>

The Consumer Advocate also disagrees with MECO’s use of the classification method known as the “minimum system” approach

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<sup>524</sup>CA Direct Testimony, CA-T-2 (Michael L. Brosch) at 105-06.

<sup>525</sup>CA Direct Testimony, CA-T-2 (Michael L. Brosch) at 106.

<sup>526</sup>CA Direct Testimony, CA-T-2 (Michael L. Brosch) at 109.

in its COS, which classifies a portion of distribution poles, conduit, conductors, and transformers as "customer" related on the basis that the buildout of an entire hypothetical distribution system is needed to serve minimum customer load.<sup>527</sup> The Consumer Advocate argues that such hypothetical assumptions ignore reality (i.e., distribution networks are not built to serve customers with little or no electric load), and that such costs should be allocated solely on a demand basis.<sup>528</sup>

That being said, the Consumer Advocate notes that MECO proposed a revenue increase as an equal percentage increase over revenues at current effective revenues within each division and across each customer class, even though such equal allocations are not supported by the COS.<sup>529</sup> Notwithstanding the Consumer Advocate's aforementioned concerns regarding the impacts of DER and the minimum system method, the Consumer Advocate concludes that "[u]nder these circumstances and given the relatively small overall revenue change that is required in this Docket, particularly after consideration is given to the [2017 Tax Act] impacts, the Consumer Advocate agrees with the

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<sup>527</sup>See CA Direct Testimony, CA-T-2 (Michael L. Brosch) at 114-15.

<sup>528</sup>See CA Direct Testimony, CA-T-2 (Michael L. Brosch) at 114-15.

<sup>529</sup>See CA Direct Testimony, CA-T-2 (Michael L. Brosch) at 102-03 and 116-17.

Company's proposed 'equal percentage to customer classes' increase approach."<sup>530</sup> However, the Consumer Advocate affirms that "[l]arger changes to MECO's rate structure should be considered in the DER Docket, with the design of [COS] analyses in future rate cases informed by the Commission's decisions in that Docket."<sup>531</sup>

Regarding MECO's proposed rate design, while the Consumer Advocate generally agrees with MECO's policy goals, the Consumer Advocate cautions moderation. Consequently, "the Consumer Advocate does not support major shifts in cost recovery toward customer and demand charges at this time."<sup>532</sup> As noted above, the Consumer Advocate supports further analysis of cost allocation, market structure, and pricing issues in the DER Docket, and maintains that "major changes" in cost recovery should be avoided during the interim.<sup>533</sup> Accordingly, the Consumer Advocate proposed its own rate design with more modest increases to the customer charges, minimum charges, and demand charges for each rate class.<sup>534</sup>

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<sup>530</sup>CA Direct Testimony, CA-T-2 (Michael L. Brosch) at 118.

<sup>531</sup>CA Direct Testimony, CA-T-2 (Michael L. Brosch) at 118.

<sup>532</sup>CA Direct Testimony, CA-T-2 (Michael L. Brosch) at 118-19.

<sup>533</sup>See CA Direct Testimony, CA-T-2 (Michael L. Brosch) at 119.

<sup>534</sup>See CA Direct Testimony, CA-T-2 (Michael L. Brosch) at 119-20. For the Consumer Advocate's specific proposed dollar amount increases, see id. at 120-30 and Exhibit CA-202. See also, Settlement Agreement, Exhibit 1 at 123-24.

Regarding MECO's proposed TOU rate design changes, the Consumer Advocate states that it has not finalized its position on how MECO's optional TOU rates should be structured:

MECO's efforts to conform its TOU tariff designs in this rate case to proposals advanced by the HECO Companies that are under consideration in the DER Docket, while maintaining alignment to changes in related rate schedules, are generally reasonable. [Exhibit] CA-202 contains the revisions to MECO's TOU rate schedules that are needed to maintain existing linkages with the related traditional rate schedules.

The Consumer Advocate agrees with Mr. Young that it is appropriate for changes to TOU residential and commercial rate design to be evaluated in the DER Docket, so that standardized time of use rate structures can be established for all Hawaiian Electric Companies and that any TOU rate designs approved in this proceeding be aligned with the TOU ratemaking methods ultimately approved in the DER proceeding.<sup>535</sup>

In addition to the specific dollar amount changes to MECO's proposed rate design, the Consumer Advocate also proposes revising MECO's demand ratchet for Schedules J and P. As described by MECO, a demand ratchet is premised on the understanding that generation, transmission, and distribution facilities have been sized to meet a customer's maximum demand; concomitantly, a demand ratchet "is used as a proxy to assign to customers a partial

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<sup>535</sup>CA Direct Testimony, CA-T-2 (Michael L. Brosch) at 130-31 (internal citations omitted).

contribution towards the cost recovery for the costs of the generation, transmission, and distribution for its maximum demand, when the customer does not use that maximum demand, in order that such costs are not entirely shifted to other customers."<sup>536</sup> The Consumer Advocate observes that MECO's demand ratchet was last adjusted in its 2007 test year rate case, and recommends modifying the ratchet provision to "employ a shortened look-back period, reducing the existing 11-month period to 3 months, so as to accelerate the ability of a customer's ability to monetize benefits from any energy efficiency measures that have been deployed."<sup>537</sup>

iii.

The Parties' Stipulation Regarding Rate Design

For purposes of reaching a settlement, MECO proposes that "a determination of appropriate cost-of-service methodology is not necessary to establish the allocation of the revenue increase in this case, [and] that for both the interim rate increase and final rate increase in this case, revenue increases to classes shall be allocated based on assigning the dollar amount that results from applying the same percentage increase to revenues

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<sup>536</sup>CA Direct Testimony, CA-T-2 (Michael L. Brosch) at 127-28 (citing MECO response to CA-IR-463).

<sup>537</sup>CA Direct Testimony, CA-T-2 (Michael L. Brosch) at 128.

at current effective rates for each rate class, and that cost of service and rate structures for DER customers shall be presented in the DER proceeding rather than in utility rate cases."<sup>538</sup> As noted above, the Consumer Advocate does not oppose this approach and appears to accept it for purposes of reaching a global settlement.<sup>539</sup>

Consequently, the Parties have agreed to specific rate schedules for each of the rate classes across all of MECO's island divisions. In general, the Parties have agreed to adopt the Consumer Advocate's more moderate increases to the rate classes' customer charges, minimum charges, and demand charges, while compromising on the increase in Schedule R customer charges.<sup>540</sup> Regarding MECO's various TOU schedules, the Parties have agreed to revise Schedule TOU-R and TOU-EV to maintain their same relationship relative to Schedule R under existing rates.<sup>541</sup> Regarding TOU-RI, the customer and minimum charges are updated to mirror the proposed Schedule R charges and the Parties agree to update the TOU charges based on applicable 2018 cost of service

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<sup>538</sup>Settlement Agreement, Exhibit 1 at 119.

<sup>539</sup>See Settlement Agreement, Exhibit 1 at 119.

<sup>540</sup>Compare CA Direct Testimony, Exhibit CA-202 with Settlement Agreement, Exhibit 1 at 124-127.

<sup>541</sup>Settlement Agreement, Exhibit 1 at 126.



values for Schedule R.<sup>542</sup> For Schedules TOU-G, TOU-J, and TOU-P, the Parties agree to implement the same three daily time periods as used in Schedule TOU-RI, using the same discounts and premiums relative to the regular rate schedules in the existing Schedules TOU-G, TOU-J, and TOU-P, but re-distributed based on the TOU-RI rating periods.<sup>543</sup>

In addition, consistent with MECO's Direct Testimony, the Parties agree to close Rider T to new enrollment and modify the Schedule EV-F energy rates for each division consistent with the methodology proposed and approved by the commission in Docket No. 2016-0168.<sup>544</sup> The Parties have also agreed to various miscellaneous changes to MECO's tariffs, including: (1) Service Voltage Adjustments for Schedules G, J, and P, where such adjustments are provided for, based on 2018 Test Year assumptions; (2) modifying the PPAC allocation factors from the 2018 Test Year COS; (3) slight modifications to Rule Nos. 3, 7, and 8;<sup>545</sup> and (4) modifying the RBA tariff to incorporate additional PIM revenues.<sup>546</sup>

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<sup>542</sup>Settlement Agreement, Exhibit 1 at 126.

<sup>543</sup>Settlement Agreement, Exhibit 1 at 126.

<sup>544</sup>Settlement Agreement, Exhibit 1 at 127.

<sup>545</sup>See Application at 25.

<sup>546</sup>See Settlement Agreement, Exhibit 1 at 125.

Approving The Parties' Stipulated Rate Design

Upon review, the commission finds the Parties' stipulated rate schedules reasonable. In general, the Parties have adopted the Consumer Advocate's more cautious approach to shifting cost recovery to minimum and customer charges, resulting in more moderate increases to these fixed charges (as noted in MECO's Direct Testimony, the balance of cost recovery will occur through energy charges). As noted by the Consumer Advocate, the significant increase in DER in Hawaii has begun to distort the traditional assumptions underlying COS studies and rate design. While the commission appreciates the Companies' initiative in attempting to address this issue by shifting larger proportions of cost recovery to fixed charges,<sup>547</sup> such as the customer charge and minimum charge, the commission agrees with the Consumer Advocate that a more cautious approach is appropriate at this time, given the lack of reliable data and potential for inadvertent consequences.

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<sup>547</sup>Many DER users receive credits or discounts to their energy charges, with the result being that fixed charges are generally the only available means to recover system costs from such customers.

Regarding Rider T, the commission finds the Parties' stipulation reasonable as well, given that Rider T is no longer consistent with the tri-rate period approach being developed in the various optional TOU Schedules. The commission also approves the Parties' other stipulated changes to MECO's tariffs, as they appear largely administrative and/or responsive to the stipulated 2018 Test Year revenue requirement.

As noted by the Parties, the commission has identified changes to rate design as an issue for consideration in Phase 2 of the DER Docket No. 2014-0192. The commission agrees that this issue should be addressed in that proceeding, where a thorough and comprehensive review of pertinent considerations can occur before application in a general rate case.

10.

Implementation Of Final Rates

As noted by the Parties in the Settlement Agreement, "[a]ll rate design changes and rule changes will be implemented when the Final Increase is implemented."<sup>548</sup>

Accordingly, MECO shall collaborate with the Consumer Advocate to develop and submit revised tariff sheets reflecting the rulings set forth above for the commission's review

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<sup>548</sup>Settlement Agreement, Exhibit 1 at 125.

within thirty (30) days of this Decision and Order (this does not include the submission of MECO's proposed ECRC tariff, which, as noted above, is subject to a separate review process).<sup>549</sup>

D.

HRS § 269-16(d) Statutory Refund Provision

HRS § 269-16(d) states, in relevant part:

Notwithstanding subsection (c), if the commission has not issued its final decision on a public utility's rate application within the nine-month period stated in this section, the commission, within one month after expiration of the nine-month period, shall render an interim decision allowing the increase in rates, fares and charges, if any, to which the commission, based on the evidentiary record before it, believes the public utility is probably entitled. The commission may postpone its interim rate decision for thirty days if the commission considers the evidentiary hearings incomplete. In the event interim rates are made effective, the commission shall require by order the public utility to return, in the form of an adjustment to rates, fares, or charges to be billed in the future, any amounts with interest, at a rate equal to the rate of return on the public utility's rate base found to be reasonable by the commission, received under the interim rates that are in excess of the rates, fares, or charges finally determined to be just and reasonable by the commission. Interest on any excess shall commence as of the date that any rate, fare, or charge goes into effect that results in the

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<sup>549</sup>See Section II.B.2.iv (Review And Approval Of The ECRC Tariff), above.

excess and shall continue to accrue on the balance of the excess until returned.

. . . . .

HRS § 269-16(d) (emphasis added).

As noted above, the commission has found that that neither the Substation Land component of the Kuihelani Project (M000197) nor all the components of the Ka`ono`ulu Project (the Ka`ono`ulu Substation component, M0001039, the Ka`ono`ulu Substation T&D Feeder component, M0001051, and the Ka`ono`ulu Substation Land/Easement component, M0001890) were used and useful during 2018 and, thus, should not be included in MECO's 2018 Test Year.<sup>550</sup> In its various responses to the commission's IRs, MECO confirmed that costs for both the Kuihelani Project and the Ka`ono`ulu Project were included in the Settlement Agreement.<sup>551</sup> Consequently, these Substation Projects' costs were incorporated into the interim rates approved by Interim D&O 35631.

As some of these costs are now found to be "in excess" of the rates approved by this final Decision and Order, they must be refunded to ratepayers, with interest, as provided under

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<sup>550</sup>See Section II.B.3 (Cost Recovery Issues Related To Docket No. 2016-0219, above.

<sup>551</sup>See MECO response to PUC-MECO-IR-3, filed October 15, 2018 at 2-3 (regarding the Ka`ono`ulu Substation Project) and MECO response to PUC-MECO-IR-6, filed January 11, 2019 at 1-2 (regarding the land component of the Kuihelani Substation Project).

HRS § 269-16(d). HRS § 269-16(d) states that these amounts may be refunded "in the form of an adjustment to rates, fares, or charges to be billed in the future . . . ." In addition, as noted above, to the extent MECO has collected revenues for its DR incentive payments through both interim rates and the DSM Surcharge, any duplicative costs must be refunded, pursuant to HRS § 269-16(d).<sup>552</sup> The commission instructs MECO to collaborate with the Consumer Advocate to develop and submit a proposed method for refunding the excess amounts associated with the Kuihelani Substation Land component and the Ka'ono'ulu Project within thirty (30) days of this Decision and Order. The Parties shall also include in that proposal an accounting and method to refund to ratepayers any excess or duplicative DR incentive payments it may have collected through interim rates and the DSM Surcharge. If MECO has not collected any duplicative costs for the DR incentive payments through both its interim rates and its DSM Surcharge, MECO may clarify this as appropriate in said proposal.

E.

Hawaii's Energy Policy Statutes

The State of Hawaii has expressed several energy policies requiring and/or encouraging reduction in the utilization

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<sup>552</sup>See Section II.B.5.ii (DSM Tariff), above.

of fossil fuels in statutes that directly pertain to the regulation of public utilities. These statutes include standards requiring minimum reductions in electric energy consumption through energy efficiency measures by specific dates;<sup>553</sup> standards requiring minimum percentages of renewable energy generation by specific dates;<sup>554</sup> provisions allowing for utility utilization and dispatch of renewable generation resources;<sup>555</sup> provisions requiring consideration of factors related to impacts of fossil fuel use in the regulation of public utilities;<sup>556</sup> and provisions that require consideration of specific resources and/or regulatory mechanisms.<sup>557</sup>

In particular, HRS § 269-6(b) provides, in relevant part:

The public utilities commission shall consider the need to reduce the State's reliance on fossil fuels through energy efficiency and increased renewable energy generation in exercising its authority and duties under this chapter. In making determinations of the reasonableness of the costs of utility system capital improvements and operations, the commission shall explicitly consider, quantitatively or qualitatively, the effect of

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<sup>553</sup>See e.g., HRS § 269-96.

<sup>554</sup>See e.g., HRS §§ 269-91 to -95.

<sup>555</sup>See e.g., HRS § 269-27.2.

<sup>556</sup>See e.g., HRS § 269-6(b).

<sup>557</sup>See e.g., HRS §§ 269-16.1 269-146, 269-147, 269-148, and 269-149.

the State's reliance on fossil fuels on price volatility, export of funds for fuel imports, fuel supply reliability risk, and greenhouse gas emissions.

The commission recognizes the importance of considering the effects that Hawaii's reliance on fossil fuels have on the State's economy and general welfare in making utility resource planning, investment, and operation decisions. In performing the duties specified in HRS Chapter 269, the commission has been diligent in implementing the State's energy policies and statutes, giving deliberate weight to these provisions in the broader context of the many other statutes and considerations necessary to regulate and provide reliable and affordable access to essential electric utility services.<sup>558</sup>

Furthermore, the composition of MECO's generation system is regularly examined in the context of long-range resource plans that are reviewed by the commission in formal regulatory proceedings.<sup>559</sup> The commission's review of MECO's long range plans

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<sup>558</sup>Some of these broader considerations (such as monetary costs) are obvious, while others are explicitly stated or implied elsewhere in statutes, and/or specified in case law in which the courts have set forth standards and interpretations regarding the determination of just and reasonable rates, which collectively include: reliability, affordability, fairness, provision of just and reasonable compensation for utility investment, and provision of just and reasonable rates to utility customers.

<sup>559</sup>See e.g., Docket No. 2014-0183 (Power Supply Improvement Plan); and Docket No. 2018-0165 (Integrated Grid Planning).



includes rigorous, explicit consideration of the State's concurrent statutory energy policies and laws. Additionally, the commission has initiated several investigative proceedings, some complete and some currently pending, that specifically address measures, resources, programs, and regulatory mechanisms that are intended to further the State's energy policies and laws and, in particular, reduce Hawaii's reliance on fossil fuel resources.<sup>560</sup> MECO's existing system, investments, capital improvements, and operations reviewed in the instant rate case proceeding incorporate the results and directives of these proceedings.

The instant proceeding is a general rate case in which determinations of the reasonableness of the costs of utility system investments, capital improvements, and operations is a central focus. The revenue requirements approved in this proceeding include both costs for owning and operating existing fossil fuel generation facilities, as well as costs associated with capital

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<sup>560</sup>See e.g., Docket No. 2003-0371 (establishing a distributed generation framework); Docket No. 2005-0069 (examination of DSM programs and establishment of a third-party energy efficiency program provider); Docket No. 2008-0273 (establishment of feed-in tariffs); Docket No. 2008-0274 (establishment of revenue decoupling to remove disincentives for energy efficiency and distributed customer generation); Docket Nos. 2007-0341 and 2015-0022 (implementation of demand response resources); Docket No. 2014-0192 (providing for distributed generation resources); and Docket No. 2018-0141 (application for approval of first phase of grid modernization).

improvements and operations for increased energy efficiency, renewable energy generation,<sup>561</sup> and reductions in fossil fuel utilization. MECO's existing system, as well as the changes and additions considered in this proceeding, are the subject of examination, review, and approval by the commission in several past and pending formal regulatory proceedings in which the State's formally expressed policies and laws are a prominent focus.

In approving MECO's final rates in this Decision and Order, the commission notes and explicitly considers that MECO's 2018 Test Year revenue requirement includes the costs of several purchases, measures, programs, and operations that specifically target reductions in fossil fuel use,<sup>562</sup> including:

Increasing purchases of renewable energy generation by contract from IPPs. MECO's 2018 Test Year revenue requirement includes costs related to MECO's Maui Division's PPAs with Ku`ia Solar LLC for up to 2.87 MW of PV power and South Maui Renewable Resources LLC for up to 2.87 MW of PV power, both of which went

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<sup>561</sup>See HRS § 269-6(b), stating "[t]he public utilities commission shall consider the need to reduce the State's reliance on fossil fuels through energy efficiency and increased renewable energy generation in exercising its authority and duties under this chapter."

<sup>562</sup>Which, in turn, serves to reduce the State's reliance on fossil fuels and any associated price volatility, export of funds for fuel imports, fuel supply reliability risk, and greenhouse gas emissions, as discussed further, below.

into operation during the 2018 Test Year.<sup>563</sup> Increasing amounts of local renewable energy generation are expected to reduce the risk of price volatility by incorporating increasing amounts of renewable energy purchased at fixed prices (and thereby displacing generation provided by market-based fossil fuels).

Investments in capital improvements intended to increase the integration of renewable resources onto MECO's system.

MECO's 2018 Test Year revenue requirement includes costs and expenses for the Ma'alaea Project, which is expected to allow MECO's Ma'alaea power plant to operate at lower loads, thereby increasing the amount of renewable energy that MECO can accommodate on its system.<sup>564</sup> Similarly, MECO will recover the costs for the Kuihelani Substation Project, which, in addition to addressing system overload concerns in the Central Maui area, can assist in the integration of renewable energy, including DER and DR resources.<sup>565</sup> In addition, the Ka'ono'ulu Substation Project

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<sup>563</sup>According to MECO, the Ku'ia Solar and South Maui Renewable Resources facilities went into commercial operation on October 4, 2018, and May 5, 2018, respectively. See Docket Nos. 2015-0224 and 2015-0225.

<sup>564</sup>See Section II.B.4, above. See also, Interim D&O 35631 at 49-52.

<sup>565</sup>See Docket No. 2015-0070, D&O 33584 at 40. While the commission is not including the costs associated with the Kuihelani Land/Easement component in MECO's 2018 Test Year, it has provided a means for MECO to potentially receive interim recovery for these costs. See Section II.B.3, above.

will address projected load growth in the South Maui area.<sup>566</sup> Increased system capacity in South Maui should likewise facilitate integrating increasing amounts of renewable energy onto MECO's system.<sup>567</sup>

Costs and expenses associated with supporting an increasing number of renewable energy programs. MECO has approximately 11,700 customers enrolled in DER programs, including Net Energy Metering, Customer Grid Supply, Customer Self Supply, SIA, and FIT that provide approximately 103 MW of as-available renewable energy.<sup>568</sup> In addition to providing customer choice, these options increase the amount of renewable energy generation placed onto MECO's system. MECO's 2018 Test Year also includes costs associated with its time-of-use (TOU-RI) and DR programs, which provide load-shifting services and, among other things, can help avoid curtailment of renewable resources. Continued progress on these offerings will help offset the need for fossil fuel-generated electricity and related ancillary services, which, in turn, mitigate concerns related to price volatility, reliance on imported fossil fuels, and greenhouse gas emissions.

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<sup>566</sup>Docket No. 2015-0071, D&O 33261 at 27-29.

<sup>567</sup>While the costs associated with the Ka'ono'ulu Project are not included in MECO's 2018 Test Year, the commission has provided MECO with a means to potentially receive interim recovery for these costs. See Section II.B.3, above.

<sup>568</sup>MECO Direct Testimony, MECO T-7 (Ellen S. Nashiwa) at 41.

Modification to MECO's ECRC (formerly the ECAC) to incorporate a risk-sharing mechanism. As discussed above, the commission has approved a modification to MECO's ECRC such that MECO is now exposed to a portion of the risk of the volatility of fossil fuel markets.<sup>569</sup> Rather than serving as a complete pass-through for fossil fuel costs, the ECRC will require MECO to share in the fuel price risks borne by customers, which provides incentive for MECO to accelerate efforts to reduce its reliance on fossil fuels.

Thus, upon explicit consideration, weighing, and balancing of the four specified criteria in HRS § 269-6(b) (price volatility, fuel supply reliability risk, export of funds for fuel imports, and greenhouse gas emissions), as well as the need to reduce the State's reliance on fossil fuels through energy efficiency and increased renewable energy generation, the commission finds reasonable MECO's 2018 Test Year utility system capital improvements and operations costs.

That being said, while the commission determines that the costs associated with these above-discussed efforts are reasonable, the pace at which MECO pursues renewable energy solutions must be accelerated.<sup>570</sup> The legislative mandates noted

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<sup>569</sup>See Section II.B.2, above.

<sup>570</sup>For example, the commission notes that MECO struggled with curtailing energy from renewable IPP projects in the past,

above, as well as Hawaii's recognized role as a leader in integrating renewable energy, demand greater progress. Going forward, the commission expects MECO to exhibit sustained initiative in pursuing and implementing renewable energy. This includes, but is not limited to, improving the speed and efficiency in resolving DER interconnection disputes, pursuing PPAs for renewable energy at competitive prices, and aggressively exploring innovative ways to further reduce its reliance on fossil fuels.<sup>571</sup>

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which resulted in the commission penalizing MECO for excessive curtailment of renewable energy, particularly from wind energy projects. See Interim D&O 35631 at 38 (referring to MECO's 2012 test year rate case, Docket No. 2011-0092).

Additionally, while MECO, along with the other HECO Companies, has increased its residential DER program offerings, the Companies continue to put forth relatively conservative proposals that frequently allocate little, if any, capacity for neighbor islands, including Maui. See generally, Docket No. 2014-0192. Relatedly, there is an ongoing concern regarding MECO's persistent challenges in interconnecting residential DER on Molokai. See October 19, 2018 Letter from Gary Kobayashi to Sharon Suzuki; MECO's "Response to Commission Letter - Moloka'i Interconnection Queue," dated November 8, 2018, from Sharon Suzuki to Gary Kobayashi; and Letter filed on October 13, 2015 from Sharon Suzuki to Gary Kobayashi.

<sup>571</sup>For example, see Docket No. 2017-0352, Order No. 36187, "Providing Guidance in Advance of the Hawaiian Electric Companies' Phase 2 Draft Requests for Proposals for Dispatchable and Renewable Generation," filed on February 27, 2019 (providing guidance to the HECO Companies in connection with their ongoing procurement process to acquire new, dispatchable, and renewable energy resources).

### III.

#### SUMMARY OF FINDINGS OF FACT AND CONCLUSIONS OF LAW

The commission summarizes its findings and conclusions discussed above:

1. MECO's 2018 Test Year revenues, expenses, and average depreciated rate base balance, as set forth in the Settlement Agreement, are reasonable, subject to the commission's modifications discussed herein.

2. A fair return on common equity, or ROE, for MECO for the 2018 Test Year is 9.50%. Based on this ROE, the commission approves, as fair and reasonable, a rate of return on average rate base of 7.43%.

3. The commission finds that MECO's ECAC shall be replaced with a new ECRC mechanism that reflects a risk-sharing mechanism based on Blue Planet's amended Option A proposal, as set forth above. Within thirty (30) days of this Decision and Order, MECO shall submit a proposed ECRC tariff consistent with the rulings herein. The Consumer Advocate and Blue Planet shall have fifteen (15) days to submit comments on MECO's proposed ECRC tariff. Thereafter, MECO shall have seven (7) days to submit reply comments on any comments filed by the Consumer Advocate and/or Blue Planet.

4. The Ka`ono`ulu Project was not used and useful to MECO's customers during the 2018 Test Year. Notwithstanding the completion of the Ka`ono`ulu Substation Land/Easement, the Project did not deliver or provide any discernable electric services to MECO's customers during the 2018 Test year and is thus excluded from MECO's final rates.

5. The Kuihelani Project's Substation component, T&D component, and Communication component were all placed in service during the 2018 Test Year and may be included in final rates. While the Kuihelani Substation Land component was not completed during the 2018 Test Year, this did not preclude the Kuihelani Project's other components from providing electric services to MECO's customers. Accordingly, the Kuihelani Substation component, Kuihelani T&D component, and Kuihelani Communication component of the Kuihelani Project were used and useful during the 2018 Test Year and may be included in MECO's final rates. Conversely, the Kuihelani Substation Land component, which was not completed during the 2018 Test Year, is not considered used and useful during the 2018 Test Year and is thus excluded from the final rates approved herein.

6. MECO may recover its costs for the Ka`ono`ulu Project and Kuihelani Substation Land component, on an interim basis until such costs are reflected in base rates, through the RAM, outside of the RAM Cap.



7. Pursuant to D&O 36159 issued in Docket No. 2016-0345, MECO may include the amortized amount of its deferred O&M expenses for the Ma`alaea Project in its 2018 Test Year. However, the unamortized balanced of the deferred O&M expenses may not be included in rate base or otherwise allowed the accrual of any carrying charge.

8. A final determination of MECO's approved revenue increase cannot be made until MECO revises its schedules of operations to reflect the commission's rulings regarding: (A) the removal of the Substation Land component of the Kuihelani Project (M0001977); (B) the removal of the entire Ka`ono`ulu Project (M0001039, M0001051, and M0001890); and (C) the incorporation of the deferred O&M expenses for the Ma`alaea Project. In addition, while not expected to change MECO's overall 2018 Test Year revenue requirement, now that the Paia Land Sale has closed, MECO shall update its schedules to reflect the gains from the sale in their proper categories. Accordingly, MECO shall collaborate with the Consumer Advocate to develop and submit proposed revised schedules of operations consistent with the rulings in this Decision and Order within thirty (30) days of this Decision and Order for the commission's review and approval.

9. The stipulated final rate design is just and reasonable.

10. MECO shall collaborate with the Consumer Advocate to develop and submit proposed tariffs reflecting final rates consistent with the rulings in this Decision and Order within thirty (30) days of this Decision and Order for the commission's review and approval.

11. Pursuant to HRS § 269-16(d), MECO shall refund ratepayers any excess amounts collected through interim rates associated with (A) the Kuihelani Substation Land component; (B) the Ka`ono`ulu Project; and (C) the Fast DR incentive costs, to the extent such costs were also recovered through the DSM Surcharge. MECO shall collaborate with the Consumer Advocate to develop and submit a proposed method to implement any refund amounts to customers within thirty (30) days of this Decision and Order.

#### IV.

##### ORDERS

###### THE COMMISSION ORDERS:

1. The Settlement Agreement is approved, in part, subject to the commission's modifications set forth in this Decision and Order.

2. The commission's approval of the Settlement Agreement, or any methodologies used by the Parties in reaching their global settlement of all issues, may not be cited as precedent in any future commission proceedings.

3. The Parties shall submit proposed revised schedules of operations which reflect: (A) removal the land component of the Kuihelani Substation Project; (B) removal of the Ka'ono'ulu Project; (C) inclusion of the Ma'alaea Project's amortized deferred O&M expenses, pursuant to D&O 36159; and (D) the proper categorization of the gains from the Paia Land Sale, all with supporting exhibits, within thirty (30) days of this Decision and Order for the commission's review and approval.

4. The Parties shall submit proposed final tariffs supporting MECO's final rates, consistent with this Decision and Order, and as supported by the revised schedules of operations, within thirty (30) days of this Decision and Order for the commission's review and approval.

5. Upon completion and placement in service of the Ka`ono`ulu Project and the Kuihelani Substation Land component of the Kuiehelani Project, MECO may begin accruing and recovering these costs, on an interim basis until such costs are reflected in base rates, through the normal operation of the RAM. However, these costs shall be excluded from the determination of MECO's RAM Cap.

6. Pursuant to HRS § 269-16(d), MECO shall refund ratepayers any excess amounts collected through interim rates associated with (A) the Kuihelani Substation Land component; (B) the Ka`ono`ulu Project; and (C) the Fast DR incentive costs, to the extent such costs were also recovered through the DSM Surcharge. MECO shall collaborate with the Consumer Advocate to develop and submit a proposed method to implement any refund amounts to customers within thirty (30) days of this Decision and Order.

7. Regarding MECO's ECRC tariff, MECO shall file a proposed ECRC tariff within thirty (30) days of this Final Decision and Order. Following MECO's submission of its draft ECRC, the Consumer Advocate and Blue Planet will have fifteen (15) days to review the draft and submit comments on MECO's draft ECRC to the commission. Following the submission of comments by the Consumer Advocate and/or Blue Planet, if any, MECO may submit reply comments to the commission within seven (7) days of receipt of

the Consumer Advocate's and/or Blue Planet's comments. Subsequent to the receipt of all timely comments, the commission will render a decision on MECO's proposed ECRC tariff, including an effective date.

DONE at Honolulu, Hawaii MAR 18 2019

PUBLIC UTILITIES COMMISSION  
OF THE STATE OF HAWAII

By James P. Griffin  
James P. Griffin, Chair

By Jennifer M. Potter  
Jennifer M. Potter, Commissioner

APPROVED AS TO FORM:

Mark Kaetsu  
Mark Kaetsu  
Commission Counsel

2017-0150.ljk

CERTIFICATE OF SERVICE

The foregoing order was served on the date of filing by mail, postage prepaid, and properly addressed to the following parties:

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